Tax Reform
not a new tax
a new tax system

The Howard Government's Plan for a New Tax System

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Foreword

Tax reform: not a new tax, a new tax system

The tax reform plan set out in this document adds an important new dimension to the Coalition Government's policy framework for securing Australia's economic future. It is a framework designed to achieve stronger sustainable growth, higher productivity, more jobs and rising living standards.

Tax reform is not an end in itself. It is an indispensable part of a broader co-ordinated policy approach that has as its goals greater incentive, security, consistency and simplicity. It also provides for fairer outcomes, greater choice and greater opportunity.

As part of that broader co-ordinated policy approach, tax reform is essential if Australia is to be able to achieve its full potential as a nation in the twenty-first century.

The tax reform which is necessary for Australia — and to which the Coalition Government is committed — is not reform narrowly focussed on establishing a new tax, but reform which delivers a new tax system: a system which is built on a lower tax burden and which is fairer, more internationally competitive, more effective, and less complex.

It is a new tax system that has as its central priorities not only the efficiency and effectiveness of our national economic policy framework but also the sense of equity and fairness that has always been part of the Australian way.

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Overview

A tax system for realising Australia's potential

The tax reform plan set out in this document constitutes generational change in the Australian taxation system. The changes proposed in personal income tax rates and thresholds, in business tax, in assistance for families, in Commonwealth-State financial relations, in simplifying and streamlining the indirect tax system, in reducing business costs (including reducing fuel costs), in making private health insurance more affordable, and in many other areas constitute historic breakthroughs.

Together with other priorities of the Coalition Government in economic policymaking, the new tax system will establish a framework for economic activity in Australia that is relevant to the twenty-first century, rather than the 1930s and 1940s. It will enhance Australia's prospects for growth, investment and job-creating exports in the global economy.

The alternatives to this plan for a new tax system are to either do nothing, or to simply tinker with the existing system by addressing its increasing failings only as they become obviously unsustainable. Both alternatives would serve Australia very poorly.

To do nothing would be blatant irresponsibility. It would require blanket denial of the way in which the current tax system is failing Australia. It would also require denial of the changed and changing realities that are now influencing Australia's economy.

To tinker and respond sporadically to the more obvious inadequacies of the existing tax system would be equally irresponsible. Partial and stopgap remedies would not address the fundamental problems of a failed tax system and would make complexity and compliance difficulties even worse.

The choice is vital for Australia's future because the taxation system affects all of us.

Choosing a new tax system means refusing to accept the inequities, inefficiencies and unfairness of the current system. It entails a

recognition that a modern tax system is one of the keys to Australia's future economic growth and dynamism.

Choosing to do nothing or trying to patch up parts of the existing system would condemn Australians to a future of higher tax rates, ever greater reliance on income taxes, more evasion and avoidance, greater unfairness, more complexity and higher penalties for Australian exports.

The choice is critical not just for today's generation of Australians, but for the next.

A new tax system will help gear up the Australian economy to meet the challenges of the twenty-first century.

If we succumb to inertia or pretend that tinkering is good enough then we will ensure that Australians enter the new millennium shackled with a tax system based on the economy of the 1930s — the costs for all Australians would be immense.

Why a new tax system is a clear national priority for Australia

Australia's economy and society have changed fundamentally over the past sixty to seventy years. Our tax system has not changed with them.

A modern and dynamic Australian economy needs a modern, fair and transparent taxation system.

Such a system needs to deliver lower and fewer taxes, and reduced business costs.

It needs to provide more incentives to work, save, invest and compete.

It needs to reward growth and employment.

It needs to avoid input taxes cascading through the production process thus penalising Australian exports, reducing our ability to compete in world markets, and holding back job growth.

It needs to be built on simplicity, consistency and certainty in law.

It needs to be fair and non-discriminatory between different sectors of the economy.

It needs to provide revenue security to the States[1] so that they are not forced to rely on narrowly based, distorting taxes.

As far as practicable, our tax system needs to avoid exemptions and loopholes that distort investment decisions and consumer choice.

Australia's current taxation system achieves none of these outcomes. No amount of further tinkering and 'band-aid' repairs will enable it to do so. Its unfairness and inefficiencies have been made increasingly worse by decades of continual patching and filling.

It is a system crying out for comprehensive reform in the national interest.

It is a system that hinders Australia's developing as a modern, dynamic and flexible economy which can meet the regional and global challenges of the next century.

We need a new tax system not only because the current one is failing Australia, but also because a new one offers a better, fairer and more dynamic way forward.

How the current tax system is failing Australia

The existing taxation system is out of date, unfair, internationally uncompetitive, ineffective and unnecessarily complex. It is a system that is preventing the development of a more efficient, relevant and accountable framework for Commonwealth-State financial relations.

An out of date system

The current tax system is more appropriate to the 1930's economy for which it was designed than to the 1990s and beyond.

The wholesale sales tax was introduced at a single rate of 2.5 per cent in the 1930s and applied to goods which at that time accounted for the bulk of Australia's economic activity. Given the structure of the economy at that time it provided a robust and stable source of revenue to fund government services.

Today the story is very different. The standard wholesale sales tax rate is now 22 per cent, the highest is 45 per cent and there are no less than six different rates. The production of goods now constitutes less than one-third of the national economy. The only way to maintain revenue as a share of total tax revenue under the existing wholesale sales tax

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1 The term 'States' is used to refer to both States and Territories.

system is to increase the rates because the tax base on which it is predicated is declining as a proportion of economic activity.

There is simply no logic in basing the Commonwealth's indirect tax system and business tax laws on the type of Australian economy which existed between the two World Wars — an economy which was dominated by goods rather than services and by a manufacturing sector targeted at domestic markets and isolated from the rest of the world by high tariff barriers.

There is simply no basis for a system of State indirect taxes on business that are highly distortionary, penalise certain sectors and have only evolved because of the various restrictions on State indirect tax powers.

There is simply no sense in persisting with a system designed when modern business structures and financial transactions, and globalised economic activity, were not even in prospect.

The Australian economy has been transformed, but the tax system has not.

An unfair system

The current tax system is unfair not only to individual taxpayers but also to the businesses which employ them.

The current personal income tax system combines high marginal rates and low thresholds. The result is that the system has eroded the incentive for many Australians on average incomes to work harder, and earn more for themselves and their families.

In the 1950s a taxpayer had to be earning 19 times average weekly earnings before paying the top marginal rate of tax. Unless there are systemic changes, by the year 2000 a taxpayer will have to earn only 1.2 times average weekly earnings to pay the top marginal tax rate.

Without any changes, a taxpayer on average earnings, shortly after the turn of the century, will be paying almost one dollar in tax for each two in additional income.

The tax mix in the Australian economy has been moving over the past two decades towards a higher share of direct taxation and a lower share of indirect taxation. Over the 1980s, indirect tax (comprising principally excise and wholesale sales taxes on goods) represented 7.2 per cent of Gross Domestic Product (GDP) compared with 5.8 per cent of GDP over the 1990s. The direct taxation of individuals and companies increased from 16.4 per cent of GDP to 17.2 per cent over the same period.

As revenue from indirect taxes has declined, more of the burden has had to be carried by the income tax system, and principally by wage and salary earners. The share of indirect tax as a proportion of revenue to the

Commonwealth Budget has fallen from 27 per cent in the 1980s to 24 per cent in the 1990s, while the share of income tax revenue has risen from 63 per cent to 70 per cent over the same period.

Without comprehensive tax reform, the tax mix will continue to shift automatically towards a greater reliance on direct taxation. Those who can afford expert advice or who (because of the size of their income) have more options open to them to minimise their direct tax will continue to have an advantage over those Australians who cannot afford such advice or do not have tax minimisation options available to them.

In short, under the current tax system, ordinary Australian wage and salary earners will carry an ever greater share of the tax burden.

The unfairness of the current system is accentuated by the disincentives built into the interaction between the tax and social security systems.

As personal income rises, more tax is paid and income support from the Government is withdrawn. The combined effect means that the highest effective marginal tax rates are paid not by the highest income earners but by low and middle income earners in receipt of some government assistance. They currently face effective marginal tax rates of 85.5 per cent or more. This destroys the incentive for low and middle income earners to get a job, earn more income or save for the future.

The current system ensures that some people are better off not looking for a job or earning more income.

A system that penalises Australian exports and discourages investment

At a time when the global competition for jobs, markets and investment is intensifying, the current tax system puts Australian exporters at a significant disadvantage in competing in overseas markets. It also disadvantages Australian firms competing with imported goods.

Australia is virtually alone in the world operating a wholesale sales tax system. Only Botswana, Ghana, Swaziland and the Solomon Islands share with Australia a persistence with this form of tax.

Australia's exports and import-competing goods and services have to bear the burden of wholesale sales taxes which cascade throughout the production and value-adding processes, while no such burden is applied to the traded goods and services sectors of our competitors. More than half the revenue from the wholesale sales tax comes from taxing goods purchased by business. It thus imposes a hidden tax on Australian exports and firms competing with imports.

The current business tax system distorts business decisions and imposes excessive compliance costs on businesses. The choice of business structures and investment is all too often determined by variations in

taxation treatment rather than the underlying profitability of the investment. These distortions are reducing the total gains to Australia from investments.

A more competitive business tax system with fewer distortions would result in the Australian investment dollar going further and in reducing Australia's reliance on overseas savings.

Australia is outdated and unique in the taxes it imposes on financial transactions to the disadvantage of our financial sector and users of financial services.

Current tax arrangements put Australian enterprises at an increasing disadvantage, and the cost of persevering with them will only get greater.

An ineffective system

The current tax system is ineffective. It provides a crumbling base from which to derive the necessary revenue to fund essential government services, including those provided to rural and regional areas as well as those provided through the social security system.

It is totally inconsistent to be committed to maintaining or increasing current levels of expenditure on social security but to be opposed to fair and systemic reform of a crumbling tax base.

In the absence of comprehensive reform, the existing tax system will only become even more ineffective. The Commonwealth will become increasingly reliant on income taxation directly levied on individuals and companies if it is to maintain funding for government services. Tax rates would rise and the system become even more unfair as those individuals and companies who had the opportunity to avoid or minimise their tax increasingly did so. The indirect tax base would continue to decline, rates would need to be increased again, and this debilitating cycle would continue.

Furthermore, under the current system the tax base of the States will become even more inadequate and more inefficient in terms of funding necessary services.

A complex system

The current tax system is unnecessarily complex. Income tax legislation has grown from about 120 pages to more than 7,000 as a result of 60 years of patching and filling. Over the past fifteen years there have been over 650 different tax policy changes announced.

The income support system has become equally complex. There are currently over 30 major different types of income support payments and

supplements under the tax and social security regimes, with variable tax requirements, income thresholds and delivery mechanisms.

The complexity of the tax system has resulted in over 70 per cent of tax returns being handled by tax agents. It also imposes high compliance costs on business and distorts investment decision-making by encouraging investments on the basis of tax effects rather than economic merit.

As the complexity of the tax system has grown, so too has the incentive for tax avoidance and minimisation.

Investments subsidised from the tax system rather than being determined by real economic returns simply transfer wealth from the general community to the investor. Resources and wealth are wasted and, as a result, our standard of living is diminished.

The benefits of a new tax system for Australia

Australia needs, and deserves, a new tax system because there are real national advantages that can flow from such a change.

A new and properly structured tax system can fix the problems of unfairness, uncompetitiveness, ineffectiveness and complexity that plague the existing system. It can do so in a way that will enable Australia to fulfil its unique potential.

The Coalition Government is committed to a new tax system because it is committed to lower, fairer and more efficient taxes.

A new tax system is necessary to give Australians more choice, more incentive and more opportunity.

A new tax system is an important element of promoting a more prosperous, more egalitarian and fairer Australian society.

A new tax system is vital if Australia is to encourage expanding, job-creating investment in our businesses, both large and small.

A new tax system is essential if Australia is to lift the tax burden on our exports to enable Australian enterprises to compete more effectively in global markets for goods, services, capital and labour.

A new tax system is essential if we are to reform antiquated Commonwealth-State financial relations and get rid of some of the State indirect taxes that are the most inefficient of all.

The revolutions in transport and communications have broken down many of the old barriers to the free flow of trade, finance and information.

An internationally competitive economy is no longer a matter of choice for countries aspiring to rising living standards into the twenty-first century. A competitive economy is essential to achieve that goal — competitive in the strength of its macroeconomic fundamentals, competitive in its production and value-adding processes, competitive in the attributes of its financial sector, competitive in its framework of corporate governance, competitive in its national infrastructure, and — very significantly — competitive in its system of taxation.

The economic crisis in Asia over the last twelve months has highlighted those realities.

No nation, including Australia, can pretend that it is immune from the forces of change that are re-shaping the global economy. The indices of national wealth and prosperity in the 1990s are very different to those of the 1970s, let alone those of the 1930s.

Australia's economic policy framework must adjust to these changed realities. The price of our failure to do so will be living standards that fall relative to the richest countries, lower economic and jobs growth, and greater unfairness in our economic and social structures.

A new tax system for Australia is a product of economic commonsense. It is a recognition of economic realities that will directly affect Australia's economic and social strength into the next century.

The tax reform plan to which the Coalition Government is committed is not aimed at additional revenue. The Commonwealth Budget has already been restored to surplus.

Once fully implemented, the Government's tax reform plan will, in fact, reduce the tax take but collect revenue in a fairer, simpler and more open way. It will do so in a way that benefits families, businesses and the wider community.

The Coalition Government's tax reform plan will deliver higher economic growth and more jobs for Australia as a result of:

- lower effective income tax rates (lifting incentives to work and save);
- lower, less distorted industry input costs;
- abolition of distorting indirect taxes;
- lower tax compliance costs;
- more secure revenue (removing the need for ad hoc tax redesign); and
- business tax reform (lifting capital productivity).

The tax reform plan: building on achievements to date

The Government's plan for a new tax system builds on its achievements to date, and reinforces its priorities for the future, in strengthening the Australian economy. Since coming to office in March 1996, the Government's key economic objectives have been to:

- restore the fundamentals of the Australian economy as the essential base on which growth, jobs, investment and opportunities could expand;
- overturn the legacy of debt and deficit which was inherited;
- ensure the strongest position possible for Australia in withstanding the impact of the largest downturn in economic growth in the Asia-Pacific region since the oil shocks of twenty five years ago;
- give greater recognition to the costs of raising a family;
- encourage innovative, export-oriented and entrepreneurial Australian businesses that can take advantage of the new growth industries that are emerging;
- facilitate an Australian economic infrastructure that is aimed at world best practice so that our producers, manufacturers and service providers can take on, and beat, the best in the world without one hand tied behind their backs;
- liberate the potential of Australia's unique human and natural assets through removing the dead hand of centralised control; and
- uphold the proud Australian tradition of a fair and open society which ensures both incentives to achieve and protection for the disadvantaged.

To achieve these objectives, the Government has pursued a clear set of policies.

Restoring economic fundamentals

A difficult but necessary process of fiscal consolidation has transformed an inherited underlying budget deficit of just over two per cent of GDP in 1995-96 into an underlying budget surplus in 1997-98 achieved without any increase in income tax rates, the company tax rate, the wholesale sales tax or petrol excise.

Budgetary reforms, including a Charter of Budget Honesty, have established world-best practice in government accountability and transparency to the electorate.

Our underlying economic environment is strong:

- underlying inflation is near its historic low;
- interest rates are at their lowest levels in over twenty five years;
- unemployment, which peaked at 11.2 per cent in December 1992 is currently around 8 per cent;
- Commonwealth net debt to GDP remains on track to be halved by the turn of the century compared to the ratio of around 20 per cent inherited in March 1996; and
- real business investment was at a record level in the March 1998 quarter.

Industrial relations

The modernisation of Australia's industrial relations system, particularly through the *1996 Workplace Relations Act*, is transforming relations between employers and employees by promoting their shared interests in building efficient, cohesive, profitable and competitive enterprises: it has led to higher productivity and sustainable real wage growth consistent with low inflation.

Financial sector

The innovative reform of Australia's financial system following the *Financial System Inquiry* is building a world-class framework for financial sector regulation that will enhance Australia's credentials as a financial centre. New competition in the financial sector is lowering costs for consumers and bringing benefits for business.

Business measures

The $1.26 billion *Investing for Growth* industry policy statement in December 1997 provided specific incentives to encourage research and development, boost investment and help Australian business capture new export markets.

The Government's strategic policy commitment to harnessing the potential of the information age will improve government services, foster new industries and get Australia online for the twenty-first century.

The modernisation of Australia's communications infrastructure has created new opportunities, expanded competition and broadened consumer choice.

The commitment to building Australia as one of the leading share-owning democracies in the world has dramatically expanded community involvement in great Australian enterprises such as Telstra.

Small business deregulation has cut red tape and reduced compliance burdens.

Microeconomic reforms, particularly in the transport sector, are creating new opportunities for Australian exporters and greater potential for growth.

Sectoral policy measures, including comprehensive policy packages in the automotive, pharmaceuticals and textile, clothing and footwear industries, are encouraging renewed investment, greater competitiveness and continued reform.

Education and training

Education and training policy is being made more relevant to the changing nature of the Australian workforce into the next century through the Government's focus on high levels of national literacy and numeracy, the revitalisation of apprenticeships and traineeships, the Work for the Dole Scheme and the provision of a genuine pathway to jobs.

Other structural reforms

A programme of Corporate Law Reform will make Australia one of the most efficient, stable and reliable places in the world to do business.

A framework for sustainable development and natural resource protection has been significantly strengthened through the $1.25 billion Natural Heritage Trust, Regional Forest Agreements, the Supermarket to Asia Council and the $525 million Agriculture-Advancing Australia package.

All these priorities are essential building blocks for ensuring an Australian economy that is growing, dynamic and competitive in the world.

Taxation

But realising Australia's full potential into the twenty-first century also demands the reform and modernisation of a taxation system that is outdated, unfair and uncompetitive.

Since March 1996, the Coalition has implemented a range of measures to reduce the tax burden, to strengthen compliance, to increase the system's fairness and to encourage investment and entrepreneurial activity. The tax reform plan outlined in this document builds on those very significant measures which include:

- changes to personal income tax including measures such as the Family Tax Initiative, incentives for private health insurance, and a tax rebate for Low Income Aged Persons to assist low income self-funded retirees;
- the Superannuation and Medicare Levy Surcharges for high income earners;
- improving the existing concessions for employee share schemes;
- a range of measures to provide assistance targeted at small business, including reducing the provisional tax uplift factor and tying it to GDP growth, reducing the Fringe Benefits Tax compliance burden for small business, capital gains tax (CGT) relief on the sale of small business assets, and CGT exemption on the sale of a small business for retirement;
- introducing a tax concession for business expenditure incurred in detecting and remedying software problems associated with the Year 2000 millennium bug, a tax rebate for landcare works, an Infrastructure Borrowings Rebate (to replace the previous tax concession); and
- a number of measures to address tax avoidance including: ending the exploitation of R&D syndicates and infrastructure borrowings tax concessions; funding for the Australian Taxation Office's High Wealth Individuals Task Force; extending the general anti-avoidance provisions; clamping down on dividend streaming and trading in franking credits; measures to prevent trafficking in trust losses; tightening thin capitalisation and residency rules to address foreign companies minimising their tax; stopping abuse of luxury car leasing; and measures to address tax avoidance through overseas charitable trusts.

Building on the base of these specific reforms, the comprehensive plan for a new tax system outlined in this document addresses the key remaining area of microeconomic reform necessary to gear up our national economy for the challenges of a new era.

A new tax system for Australia: priorities, principles and features

On 13 August 1997, the Prime Minister announced five principles of taxation reform:

- that there should be no increase in the overall tax burden;
- that any new taxation system should involve major reductions in personal income tax with special regard to the taxation treatment of families;

- that consideration should be given to a broad-based indirect tax to replace some or all of the existing indirect taxes;
- that there should be appropriate compensation for those deserving of special consideration; and
- that reform of Commonwealth-State financial relations must be addressed.

The new tax system set out in this document fulfils all of these principles, and does so through simpler and fairer arrangements.

It is a new tax system which enhances both fairness and incentive; it promotes Australian exports instead of penalising them; it is more effective; and it is simpler.

The Government's tax reform plan builds on four pillars to achieve a fairer tax system: incentive, security, consistency, and simplicity.

Incentive: a fairer tax system with greater reward for effort

The new tax system will be fairer. It provides stronger incentives to work and save.

It entails dramatic reductions in personal income tax of over $13 billion a year. This constitutes a 14 per cent reduction in personal income tax collections. It will mean that around 81 per cent of taxpayers will have a top tax rate of 30 per cent or less, compared to around 30 per cent of taxpayers currently.

The new system will also give much greater recognition to the costs of raising a family. Family benefits will be significantly increased in real terms.

From 1 January 1999, a new 30 per cent tax rebate/benefit will be available on private health insurance premiums.

Work incentives for low and middle income families will be greatly improved.

Social security recipients and lower income groups will be provided with extra assistance to ensure that they are more than just protected from the impact of tax reform on prices.

The income test for pension payments will be eased. The pensioner tax rebate and the tax rebate for low income aged people will be increased.

Special payments will be made to older Australians — pensioners and self-funded retirees — to protect the value of their savings and their retirement income after the tax reform package is implemented.

Specific anti-avoidance provisions targeted at tax avoidance through trusts will be implemented immediately.

A broad based goods and services tax (GST) will be introduced to replace existing indirect taxes and remove anomalies and complexity.

The Fringe Benefits Tax system will be made fairer by stopping abuses of welfare entitlements and avoidance of income tax surcharges.

Tax cheats and tax avoiders will be made to pay their fair share of tax by reducing opportunities to operate in the cash economy.

A luxury car tax will be applied.

A transitional price oversight regime will be established under special legislation which will give the Australian Competition and Consumer Commission (ACCC) special powers to ensure that price changes by business are consistent with changes in tax rates.

Security: sounder finances for government services

The new tax system will deliver higher economic growth through more competitive Australian exports and import competing products, as well as through higher investment driven by lower industry costs.

The Coalition Government's new tax system envisages that a range of existing indirect taxes will be abolished (eg the wholesale sales tax) or reduced (eg excises on petroleum and diesel).

Nine types of State taxes will be abolished. These include a range of stamp duties and taxes on transactions with financial institutions.

Provisional tax and the provisional tax uplift factor will be abolished.

A GST at a rate of 10 per cent will be introduced to replace the wholesale sales tax and the State taxes to be abolished. Some prices will fall and others will rise after the introduction of a GST. On average, excluding new house prices (which will be compensated by a new First Home Owners' Scheme) and tobacco, prices will rise by only 1.9 per cent by the second year of the package. But pensions and benefits will be increased by 4.0 per cent when the GST commences, and the Government will ensure that over time this increase remains at 1½ per cent above the actual Consumer Price Index (CPI) impact.

Purchases of business inputs will in effect bear no GST**.**

The costs of government are estimated to be reduced by more than $1 billion a year as a result of reduced prices for goods and services purchased by governments.

Some sectors will be excluded from the GST (eg virtually all of the health, education and childcare areas, local government rates, water and

sewerage rates and charges, and public benevolent institutions in their non-commercial activities).

The impact of the GST on residential housing will be reduced by a new First Home Owners' Scheme.

All GST revenue will go to the States providing them with access to a secure and growing source of revenue and the capacity in the medium to long term to allocate additional funding for services, such as health and education.

The annual Premiers' Conference to determine funding arrangements between the Commonwealth and States will no longer be required.

The GST rate will be locked in and will only be able to be changed by a unanimous request of State Governments and agreement by the Commonwealth Government and both Houses of the Federal Parliament.

Consistency: a tax system which boosts business and investment, and promotes Australian exports

The new tax system will lift the tax burden on Australian exports. Costs facing Australia's exporters should fall by around 3½ per cent or about $4½ billion a year. Costs will also fall for Australian firms competing with imported goods and services.

Implementation of the package of indirect tax reforms will reduce business costs by more than 3 per cent.

The Government will consult on the implementation of consistent taxation of trusts like companies under a clear, fair and simple regime of redesigned company taxation, with:

- a simplified imputation system involving full franking of all profits paid to individuals or other entities outside group structures;
- refunds of excess imputation credits for resident individual taxpayers and complying superannuation funds;
- maintenance of current tax status for distributions out of the following amounts from businesses and assets held in trusts at the commencement of the entity tax regime (including gains accrued after the start date):
  - — realised gains on pre-CGT assets;
  - — realised inflationary gains on post-CGT assets; and
  - — realised gains subject to the exemption of 50 per cent of CGT otherwise applying to goodwill on the sale of a small business;
- maintenance of current tax status for distributions by trusts out of other tax-preferred income earned prior to the new regime (excluding unrealised gains on trust assets);

- maintenance of current tax status for distributions out of realised profits freed from tax by the 50 per cent goodwill exemption after the commencement of the new regime for businesses in existing and future trusts;
- income distributed from existing and future trusts continuing to attract the primary producer averaging provisions and the farm management deposit arrangements after the commencement of the entity regime; and
- apart from the primary producer provisions, maintenance of current tax status for distributions out of the above profits by adding the amounts to contributed capital — usually at the time of sale of the associated assets.

The Government intends to broaden the benefits of the reformed company tax arrangements by applying them to other business entities offering limited liability to owners: limited partnerships, co-operatives and life insurers.

The Government will consult with business on the extent of reform of the treatment of investments, with the prospect that provides of moving towards a company tax rate of 30 per cent, as well as the prospect of CGT relief.

The payment arrangements for a GST will deliver a cash flow benefit to most businesses.

Fuel excise will be reduced by around $3½ billion a year.

The CGT rollover relief and retirement exemption for small business will be extended.

Simplicity: making the tax system easier to deal with

The structure and administration of family assistance will be revamped and consolidated to simplify arrangements and reduce confusion and inconsistencies in current arrangements.

Businesses will be able to deal with the whole of government through one business number.

Business payment and reporting systems will be simplified and standardised.

The design of tax laws will be improved and streamlined.

Key measures in the Howard Government's tax plan in more detail

Personal income tax cuts and family benefits

Personal income tax cuts totalling over $13 billion per year from July 2000.

Tax cuts to be provided to all taxpayers, with reductions in marginal tax rates for about 95 per cent of all individual taxpayers.

The tax free threshold for all taxpayers to be increased from $5,400 to $6,000 with the greatest proportionate benefit to low income earners.

A doubling of the tax free thresholds under the Family Tax Initiative to result in:

- all single income families (including sole parents) with a child under 5 years having an effective tax free threshold of $13,000, more than double the new general $6,000 threshold;
  - this provides additional assistance of $490 a year;
  - for those with two children (one of whom is under 5 years) the additional assistance is $630 a year;
  - for those with three children (one of whom is under 5 years) the additional assistance is $770 a year; and
- dual income families with one child (and single income families with no children aged under 5 years) having an increase in family tax assistance of $140 a year (a 70 per cent increase); for those with two children an increase of $280 a year; and for those with three children an increase of $420 a year.

The 20 per cent marginal tax rate to be reduced to 17 per cent.

The 34 per cent and 43 per cent marginal tax rates to be reduced to 30 per cent, with the result that over 80 per cent of taxpayers will face a marginal rate of no more than 30 per cent (compared with only 30 per cent of taxpayers now).

The threshold of the top 47 per cent marginal tax rate to be increased by 50 per cent so that it cuts in at $75,000 (almost twice projected full-time average weekly earnings in 2000) but the highest income earners still to pay an unchanged marginal rate.

Additional incentives to work and save by reducing the family benefits withdrawal rate from 50 per cent to 30 per cent and increasing the income threshold for family payments from $24,350 to $28,200. These measures will benefit around 375,000 families.

The effective marginal tax rate of low income working families to be reduced from 85.5 per cent to 61.5 per cent over a substantial range of income.

A new simpler Child Care Benefit worth up to $390 per year more than current benefits.

The overall cost of the enhanced family measures in the new tax system to be over $2 billion.

Private health insurance

From 1 January 1999, a 30 per cent tax rebate/benefit for the cost of private health insurance premiums (equal to the 30 per cent marginal tax rate) — worth approximately $600 a year for a family with a $2,000 health policy. This will be paid either as a rebate on tax or a direct payment from the government. Under the new tax system, the new tax rebate/benefit is as generous or more generous than full tax deductibility for health insurance premiums for more than 80 per cent of taxpayers.

Pensions and benefits

Increased rates of assistance to raise the maximum level of all income support payments by more than the impact of tax reform on prices as measured by the CPI.

A 4.0 per cent increase in the maximum rate of all income support payments provided to social security and veterans pensioners, other social security recipients and students in receipt of Commonwealth income support, including additional payments and allowances such as Child Disability Allowance and Mobility Allowance.

The continuing Government commitment to ensure that the single rate of pension does not fall below 25 per cent of male total average weekly earnings.

A 2.5 per cent increase in the income test free areas applied to social security, veterans and student income support payments.

The income test for pensions eased by reducing the taper rate from 50 per cent to 40 per cent, a measure which will:

- enable all 845,000 part-rate pensioners to keep an extra 10 cents of pension for every dollar of income they receive above the income test free areas;
- benefit self-funded retirees with modest incomes who will become eligible for a part-rate pension; and

- improve incentives to save for retirement by increasing the returns from such saving at the time that people retire.

The overall cost of increases in, and adjustments to, pensions and benefits will be over $3 billion in 2000-01 and around $1.8 billion per year thereafter.

Specific benefits for older Australians

A 4.0 per cent increase in age and service pensions.

Access to a new 30 per cent private health insurance tax rebate/benefit.

The pension income test withdrawal rate to be reduced from 50 per cent to 40 per cent.

A one-off untaxed Aged Persons Savings Bonus of up to $1,000 per person (available to retired people over 60 years of age and subject to an income test).

An additional untaxed and upfront lump sum Self-Funded Retirees Supplementary Bonus of up to $2,000 for retirees not in receipt of government benefits (available to retirees of age pension age and subject to an income test).

Both the Aged Persons Saving Bonus and the Self-Funded Retirees Supplementary Bonus, costing $1.3 billion, to be calculated on the basis of a dollar of Bonus for each dollar of income from savings and investments in 1998-99 or 1999-00.

Both Bonuses to be targeted to lower income groups with taxable incomes less than $20,000 in 1998-99 or 1999-00 and phasing out between $20,000 and $30,000.

The personal income tax free threshold to be increased to $6,000.

The 20 per cent marginal tax rate to be cut to 17 per cent.

The 34 per cent and 43 per cent marginal tax rate to be reduced to 30 per cent.

The Pensioner and Aged Persons Tax Rebates to be increased by $250 for singles and $175 per person for couples, resulting in 70,000 additional part-pensioners and self-funded retirees paying no income tax and providing an extra tax cut to 330,000 older Australians.

Provisional tax and the provisional tax uplift factor to be abolished and replaced with a new pay as you go system of tax payments.

Cash refunding of excess imputation credits paid in respect of dividends and other relevant investment income — worth up to $563 per $1,000 of dividend income based on the current 36 per cent company tax rate.

Indirect tax reform

A GST to replace the existing indirect tax mess

The wholesale sales tax to be abolished.

In consultation with the States, the following nine types of taxes to be abolished:

- Financial Institutions Duty;
- debits tax;
- stamp duty on marketable securities;
- conveyancing duties on business property;
- stamp duties on credit arrangements, instalment purchase arrangements and rental (hiring) agreements;
- stamp duties on leases;
- stamp duties on mortgages, bonds, debentures and other loan securities;
- stamp duties on cheques, bills of exchange and promissory notes; and
- 'bed taxes'.

Introduction of a 10 per cent broad based GST to replace the wholesale sales tax, State taxes on bank transactions, stamp duties on business related transactions and 'bed taxes'.

Registered persons to be able to claim input tax credits for the GST paid on purchases of business inputs.

Activities to be GST-*free* include:

- exports of goods and services;
- international air and sea travel, and domestic air travel, purchased overseas by non residents;
- virtually all the health, education and childcare services;
- charitable activities;
- religious services; and
- taxes and charges leveled at all levels of government (including local government rates and water and sewerage rates and charges).

Very small businesses with a turnover less than $50,000 per year and non-profit organisations with a turnover of less than $100,000 a year will not have to register (but may choose to do so).

A First Home Owners' Scheme to be introduced to offset the net impact of the GST on the price of new homes (excluding land ie construction costs only) and entitling those eligible to a lump sum payment of $7,000 from 1 July 2000.

Legislation to provide the ACCC with special transitional powers to formally monitor retail prices and Commonwealth-State consultations to give the ACCC the power to take action, including imposing penalties up to $10 million against businesses that adjust prices in a way that is inconsistent with changes in tax rates.

A Tax Consultative Committee chaired by a distinguished Australian, including selected community representatives, will be appointed to assist the Government in targeted consultation on outstanding GST design issues.

Petroleum fuels

Excises on petrol and diesel to be reduced at the time of the GST's introduction so that pump prices need not rise.

Businesses to pay less for petrol and diesel because they will be able to claim an input tax credit on the GST payable on fuel used for business purposes — businesses will save around 7 cents per litre relative to what they pay now.

A new comprehensive diesel fuel credit delivered through the GST system to be introduced for registered businesses, removing the need for the Diesel Fuel Rebate Scheme, with the effect that:

- effective excise payable on diesel fuel used in heavy transport and rail to be reduced from around 43 cents per litre to 18 cents per litre; and
- all other off-road use of diesel (including marine business use) to qualify for a full credit of all diesel excise.

The overall cost of petroleum fuel measures in the new tax system to be around $3½ billion.

Alternative fuels to remain excise free on the introduction of the GST.

Alcoholic beverages

Wine, and beverages consisting primarily of wine, to become subject to a Wine Equalisation Tax to replace the difference between the current 41 per cent wholesale sales tax and the proposed GST, with the concessional taxation treatment of the alcohol content of cask wine to be preserved.

Changes in the excise on beer to be limited so that the retail price of a carton of full strength beer need only increase by the estimated general price increase associated with indirect tax reform. The retail price of a carton of low alcohol beer should not increase and in some cases may fall slightly.

Tobacco

A ‘per stick’ excise on cigarettes to be introduced from 1 July 1999 without reduction in tobacco excise — a reform long advocated by health experts.

Luxury car tax

A retail tax of 25 per cent on luxury cars (above a GST inclusive $60,000 threshold) to be applied after the introduction of the GST to ensure that luxury cars fall in price only by the same amount as a car just below the luxury threshold.

Gains for businesses

Business costs to be reduced by more than 3 per cent as a result of the indirect tax reform package.

The cost of private investment goods expected to fall by around 7 per cent.

Costs facing Australian exporters should fall by about 3½ per cent or around $4½ billion. The costs facing Australian firms competing with imports will also fall.

Payment arrangements for the GST to deliver a cash flow benefit to most businesses.

A range of existing inefficient and distorting indirect taxes to be abolished (see ‘Indirect tax reform’ above).

Provisional tax and the provisional tax uplift factor abolished and replaced by a new pay as you go system (see ‘Tax simplification’ below).

More generous CGT rollover relief and retirement exemption to be extended for small business to include land and buildings integral to a business when these assets are owned separately.

Simpler tax administration for businesses with a single quarterly tax statement and payment for most businesses, together with a single Australian Business Number for all Commonwealth Government compliance and registration requirements (see ‘Tax simplification’ below).

Consistent tax treatment between companies and trusts, with refunding of excess imputation credits and special grandfathering arrangements for trusts to avoid an inappropriate impact of the new arrangements on existing trusts.

Consultations with the business sector on the extent of reform of the business investment base, and the prospect of further CGT relief and of moving towards a 30 per cent company tax rate, subject to the need to maintain revenue neutrality.

A special Small Business Consultative Committee will be involved in consultations to ensure that financial incentives, worth up to $500 million, for small and medium businesses to minimise the start-up costs of a GST are delivered in the most effective way.

Gains for rural and regional Australia

Acknowledging the high cost of transport particularly for rural and regional Australia, a new diesel fuel credit scheme to effectively reduce diesel excise for all off-road (including marine) users from 43 cents per litre to zero, and for larger transport users (including rail) from 43 cents per litre to 18 cents per litre.

This is on top of savings of 7 cents per litre for business users of petrol and diesel through their access to a refund of the GST paid on fuel.

For other consumers, there need be no rise in petrol and diesel prices as a result of the GST.

Reduces exporters' costs by a total of $4½ billion — to the particular benefit of primary producers.

Other changes in business taxation (see ‘Gains for businesses’ above).

Transformation of Commonwealth-State financial relations

The budgetary position of the States to be enhanced over time by the new tax system, with the States projected to gain about $370 million in 2003-04, $1.25 billion in 2004-05, with commensurately larger gains in subsequent years.

From 1 July 2000, the Commonwealth to provide States with a stable and growing source of revenue by giving them all the revenue from the GST, conditional on the States abolishing inefficient taxes (such as the Financial Institutions Duty, the debits tax and various stamp and conveyancing duties), and not re-introducing them, with Financial Assistance Grants to be abolished.

The States, better-resourced through the new tax system, to take responsibility for the payments of general purpose assistance to local government currently made by the Commonwealth. The Commonwealth will make the payment of GST revenue conditional on the States making these payments in accordance with existing conditions. This will ensure that local government is not worse off in that respect. In fact, overall local government will gain from the removal and reduction of Commonwealth and State taxes that currently increase their running costs.

Locking in the GST rate

Any request for a change to the GST rate would need to be made to the Commonwealth unanimously by all State Governments: it would need to be endorsed by the Commonwealth Government of the day; and relevant legislation would need to be passed by both Houses of Federal Parliament.

Tax simplification

Family assistance

The structure of assistance for families to be simplified from July 2000 after community consultations with the aim of consolidating the types of assistance for families through the tax and social security systems from twelve to three.

The delivery of family assistance to be simplified and integrated through a new Family Assistance Office within the Tax Office — a joint venture between Centrelink and the Tax Office.

Business payment and reporting

Each business to have only one number (the Australian Business Number) to identify a business for all Commonwealth purposes. The number can be adopted for State registration if the States agree to do so.

Each business to be able to deal with all Commonwealth agencies and obtain information and assistance through one, or as few as possible, entry points.

Five payment and reporting systems (Pay As You Earn, the Prescribed Payments System, the Reportable Payments Scheme, provisional tax and company tax instalments) to be replaced by one new comprehensive pay as you go system.

More certainty to be provided about which payments made by businesses for work are subject to withholding arrangements.

Other measures

To reduce uncertainty and compliance costs, the period in which the Tax Office can amend assessments of wage and salary earners to be reduced from four to two years.

Oral advice on simple tax issues to be binding on the Tax Commissioner.

The Tax Office rulings system will be made more comprehensive and its scope more certain.

The tax laws to be brought together in a code that supports a more cohesive approach to compliance and administration.

Measuring the benefits from reform

Impacts on individual taxpayers

The Government's reforms to personal tax and family benefits will more than compensate for the effect of the small net increase in indirect taxes.

Special assistance will also be provided to other groups deserving of special consideration, including low income earners who rely on government benefits and self-funded retirees.

Table O.1: Weekly cash gain from reform after the GST and inflation effect

	Individual		Couple, no children*				Sole parent	
Private income	Single Person $ gain	%	Single income $ gain	%	Dual incomes $ gain	%	1 child (<5yrs) $ gain	%
$0	$2.54	1.5%	$4.59	1.5%	$4.59	1.5%	$25.97	9.3%
$5,000	$5.44	2.5%	$7.49	2.1%	$7.26	1.9%	$26.68	7.4%
$10,000	$7.61	3.3%	$9.25	2.5%	$10.67	2.7%	$18.40	4.5%
$15,000	$5.82	2.3%	$11.35	2.9%	$12.13	2.9%	$21.11	4.7%
$20,000	$4.28	1.3%	$9.02	2.2%	$13.36	3.0%	$22.40	4.7%
$25,000	$5.10	1.3%	$13.82	3.3%	$14.43	3.2%	$26.77	5.3%
$30,000	$7.78	1.7%	$7.30	1.5%	$5.25	1.0%	$50.92	10.0%
$35,000	$10.46	2.0%	$9.98	1.8%	$5.46	0.9%	$28.90	5.1%
$40,000	$16.66	2.9%	$16.17	2.7%	$8.28	1.3%	$35.10	5.6%
$45,000	$28.13	4.4%	$27.64	4.2%	$10.63	1.5%	$46.57	6.8%
$50,000	$39.60	5.8%	$39.11	5.5%	$12.91	1.7%	$58.04	7.9%
$55,000	$45.39	6.2%	$44.90	5.9%	$15.19	1.8%	$63.83	8.1%
$60,000	$51.18	6.5%	$50.69	6.2%	$21.34	2.4%	$69.62	8.3%
$65,000	$56.97	6.8%	$56.48	6.5%	$27.42	2.8%	$75.41	8.5%
$70,000	$62.76	7.1%	$62.27	6.8%	$36.02	3.5%	$103.42	11.3%
$75,000	$68.55	7.3%	$68.06	7.1%	$44.86	4.2%	$101.61	10.6%
$80,000	$67.62	6.8%	$67.14	6.6%	$49.62	4.4%	$93.45	9.2%
$90,000	$65.78	6.0%	$65.29	5.9%	$59.15	4.8%	$91.60	8.2%
$100,000	$63.93	5.4%	$63.44	5.2%	$68.67	5.1%	$89.76	7.4%
$125,000	$59.31	4.1%	$58.83	4.0%	$86.45	5.3%	$85.14	5.8%
$150,000	$54.69	3.2%	$54.21	3.2%	$102.29	5.5%	$80.52	4.7%

* Dual income couple, assumes earnings split 67%:33%

Table O.1: Weekly cash gain from reform after the GST and inflation effect (continued)

	Single income family				Dual income family *			
	1 child (<5yrs)		2 children (1:<5yrs, 1:5-12yrs)		1 child (<5yrs)		2 children (1:<5yrs, 1:5-12yrs)	
Private income	$ gain	%	$ gain	%	$ gain	%	$ gain	%
$0	$12.80	3.4%	$14.47	3.4%	$12.80	3.4%	$14.47	3.4%
$5,000	$15.70	3.7%	$17.38	3.7%	$11.95	2.7%	$13.63	2.7%
$10,000	$17.46	4.0%	$19.13	3.9%	$15.28	3.3%	$16.95	3.3%
$15,000	$19.56	4.3%	$21.23	4.1%	$28.99	6.1%	$30.67	5.8%
$20,000	$33.31	7.1%	$34.99	6.7%	$31.89	6.5%	$33.56	6.1%
$25,000	$24.99	5.1%	$21.82	3.9%	$30.16	5.9%	$33.99	5.9%
$30,000	$43.63	8.4%	$55.79	9.9%	$35.21	6.7%	$47.37	8.3%
$35,000	$18.74	3.2%	$57.85	9.7%	$7.85	1.3%	$46.96	7.7%
$40,000	$24.93	3.9%	$35.27	5.4%	$10.67	1.6%	$21.01	3.1%
$45,000	$36.40	5.2%	$38.79	5.5%	$13.02	1.8%	$15.40	2.1%
$50,000	$47.88	6.4%	$50.26	6.6%	$15.30	1.9%	$17.68	2.2%
$55,000	$53.67	6.7%	$56.05	6.9%	$17.58	2.0%	$19.96	2.3%
$60,000	$59.45	7.0%	$61.84	7.2%	$23.73	2.6%	$26.11	2.8%
$65,000	$75.01	8.4%	$67.63	7.4%	$29.81	3.0%	$32.19	3.2%
$70,000	$93.26	10.1%	$83.19	8.7%	$50.86	5.0%	$40.79	3.9%
$75,000	$91.45	9.4%	$121.70	12.5%	$52.10	4.8%	$82.35	7.6%
$80,000	$83.28	8.1%	$97.76	9.6%	$49.62	4.4%	$64.10	5.7%
$90,000	$81.44	7.2%	$81.44	7.2%	$59.15	4.8%	$59.15	4.8%
$100,000	$79.59	6.5%	$79.59	6.5%	$68.67	5.1%	$68.67	5.1%
$125,000	$74.97	5.1%	$74.97	5.1%	$86.45	5.3%	$86.45	5.3%
$150,000	$70.35	4.1%	$70.35	4.1%	$102.29	5.5%	$102.29	5.5%

* Dual income couple, assumes earnings split 67%:33%

Table O.1:
Weekly cash gain from reform after the GST and inflation effect (continued)

	Pensioners				Self-funded retirees (a)			
Private income	Single $ gain	Single %	Couples* $ gain	Couples* %	Single $ gain	Single %	Couples* $ gain	Couples* %
$0	$2.89	1.5%	$4.81	1.5%	$0.00	0.0%	$0.00	0.0%
$5,000	$9.43	3.5%	$6.17	1.5%	$3.00	3.1%	$7.51	6.6%
$10,000	$19.05	6.5%	$23.48	5.1%	$1.21	0.6%	$5.94	3.0%
$15,000	$25.00	7.6%	$27.73	5.7%	$8.01	2.9%	$4.21	1.4%
$20,000	$25.06	7.0%	$36.51	7.1%	$9.70	2.8%	$2.42	0.6%
$25,000	$24.84	6.3%	$45.68	8.4%	$7.50	1.9%	$16.24	3.5%
$30,000	na	na	$53.14	9.2%	$7.78	1.7%	$18.06	3.4%
$35,000	na	na	$64.57	10.6%	$10.46	2.0%	$19.76	3.4%
$40,000	na	na	$50.42	7.6%	$16.66	2.9%	$18.16	2.7%
$45,000	na	na	$23.03	3.2%	$28.13	4.4%	$13.59	1.9%
$50,000	na	na	na	na	$39.60	5.8%	$15.00	1.9%
$55,000	na	na	na	na	$45.39	6.2%	$15.28	1.8%
$60,000	na	na	na	na	$51.18	6.5%	$15.56	1.7%
$65,000	na	na	na	na	$56.97	6.8%	$18.24	1.9%
$70,000	na	na	na	na	$62.76	7.1%	$20.92	2.0%
$75,000	na	na	na	na	$68.55	7.3%	$23.60	2.1%
$80,000	na	na	na	na	$67.62	6.8%	$33.31	2.9%
$90,000	na	na	na	na	$65.78	6.0%	$56.26	4.4%
$100,000	na	na	na	na	$63.93	5.4%	$79.20	5.8%
$125,000	na	na	na	na	$59.31	4.1%	$108.15	6.7%
$150,000	na	na	na	na	$54.69	3.2%	$137.09	7.3%

* Dual income couple, assumes earnings split 50%:50%.
(a) Gains for self-funded retirees will be larger to the extent they benefit from refundable imputation credits and the new private health insurance tax rebate/benefit.

Price and distributional impacts are described in detail in Chapter 5.

Impact on Government finances

The following table summarises the budgetary impact of the Government's reforms. For both revenue and outlays, a positive number indicates a positive impact (improvement) in the Budget balance.

The figuring in the package includes the cost of the new private health insurance initiative. Two indirect impacts on government budgets are also incorporated. The first is the reduced cost of Commonwealth and State government operations due to indirect tax reform (eg removal of wholesale sales tax and fuel tax reforms), estimated at more than $1 billion from 2000-01. The second indirect impact captures the effect on revenue of enhanced GDP flowing from the lower cost of investment and a more efficient allocation of resources. This impact has been estimated conservatively at some $500 million a year.

The GST revenue numbers contained in the package are consistent with assuming 95 per cent compliance on a tax base which incorporates an ATO estimate of some $18 billion of cash economy activity. The package also factors in up to $1½ billion a year in enhanced income tax compliance due to the administration reforms detailed in Chapter 4.

Table O.2: Impact of measures on the Budget

Commonwealth	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Direct tax				
Personal	0.72	-11.69	-11.86	-12.78
Business	0.12	1.67	0.97	0.65
Administration	0.21	1.72	4.03	2.86
Indirect tax	-0.31	-9.39	-11.53	-12.42
Other revenue	0.00	1.05	0.85	0.99
Outlays (incl. PDI)	-1.90	11.89	12.74	13.46
Impact on underlying Commonwealth budget (a)	**-1.16**	**-4.76**	**-4.80**	**-7.25**
States, Territories and local government				
Indirect tax				
GST revenue	0.00	27.20	31.96	32.81
Taxes abolished/reduced	0.00	-8.19	-12.38	-12.76
Other revenue (b)	0.00	-17.98	-17.57	-18.74
Outlays	0.00	-1.72	-1.32	-1.31
Impact on State, Territory and local government budgets (a)	**0.00**	**-0.69**	**0.69**	**0.00**

(a) As a consequence of the Commonwealth's one year interest free loan to the States in 2000-01, the net financing requirement of the States will be unaffected by tax reform in each of the years 1999-00 to 2002-03. The impact on the headline balance for the Commonwealth is -$1.16 billion in 1999-00, -$5.45 billion in 2000-01, -$4.12 billion in 2001-02 and -$7.25 billion in 2002-03.

(b) Principally due to the abolition of Financial Assistance Grants.

A timetable and process for reform

A reform package of the scope contemplated by the Government requires considerable time to implement. Legislation needs to be drafted and enacted. There is the need to develop, in some cases, new computer and other administration systems. Taxpayers need to be informed about their obligations under the new system and given time to adjust.

Post-election	Consultation on outstanding design and implementation issues will commence immediately after the next Federal election and continue over the following months. A Special Premiers' Conference will be held to discuss Commonwealth-State issues.
January 1999	Commencement of private health insurance initiative.
First Half 1999	Legislation to enact the GST and remove/reform other Commonwealth indirect taxes.
Mid 1999	ATO to begin to assist entities with registration for GST and set-up advice on obligations.
July 1999	Introduction of a per stick excise on tobacco to replace the existing weight based excise.
Second Half 1999	Legislation for the consistent treatment of different business entities including taxing trusts under the proposed redesigned company tax arrangements.
May 2000	Final day for GST registration and allocation of an Australian Business Number for existing entities.
July 2000	Payment of the Aged Persons Savings Bonus and Self-Funded Retirees Supplementary Bonus to eligible people. New personal income tax rates take effect. Additional assistance to families through extending the Family Tax Initiative and easing the income test for Family Allowance. Reduction in the number of different types of family assistance from 12 to 3. Increases in social security and veterans' pensions and allowances and student income support payments and adjustment of income tests (see page 57 for a full listing). Reduction in pension income test taper takes effect. Wholesale sales tax ceases and GST commences with GST revenue going to the States. Luxury car tax commences. Financial Assistance Grants abolished. State 'bed taxes' abolished. ATO sends out electronic returns to monthly GST remitters (ie those firms with sales greater than $20 million). Temporary arrangements which replaced the previous State business franchise fees on petrol, alcohol and tobacco cease. Introduction of the new entity tax regime to apply to companies, trusts, life insurers, limited partnerships and cooperatives.
August 2000	Earliest date for first lodgment of electronic GST monthly returns.

September 2000	ATO sends out paper and electronic GST returns to quarterly payers.
October 2000	Earliest date for lodgment of first quarterly GST returns.
January 2001	State abolition of Financial Institutions Duty and debits tax.
July 2001	Selected State stamp duties removed.

An ongoing process of consultation

The breadth of reform the Government is pursuing increases the need for ongoing and targeted consultation following the next Federal election to ensure successful implementation.

Consultation is required to ensure the final design and draft legislation deliver the Government's policy objectives. Some reform proposals are already well advanced in design, while with others the policy intent is clear but the design would benefit from consultation with those most affected. There are four elements of the post-election consultation and implementation strategy.

- The Prime Minister and Treasurer will meet with all **Premiers, Chief Ministers and State Treasurers** shortly after the next Federal election to discuss the proposed reform to Commonwealth-State financial relations. This process will be assisted by a Working Group of Commonwealth and State officials under the chairmanship of the Commonwealth Treasury.

- The **Taxation Task Force** will continue, supported by a group of working committees, and will consult on outstanding areas of policy and associated legislation.

- A Tax Consultative Committee chaired by a **distinguished Australian**, including selected community representatives, will be appointed to assist the Government in targeted consultation on outstanding GST design issues. Secretariat support for this committee will be provided by the Commonwealth Treasury.

- A **CEO reporting group** will be established at the Commonwealth level to report to government on the progress of implementation and delivery systems for tax reform.

A process will be established for consultation on business tax reform.

In addition, a Small Business Consultative Committee will be involved in consultations on the best way of delivering the GST start up incentives to business.

More details on the areas for consultation are contained in the relevant chapters.

Revenue measures table: the complete package*

Commonwealth		1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Personal tax					
Personal income tax cuts		0.00	-13.06	-13.52	-14.49
Delivery of half of family package (a)		0.00	-1.16	-1.22	-1.28
Increase in pensioner and self-funded retiree rebates		0.00	-0.08	-0.08	-0.08
Tax rebate/benefit for private health insurance (b)		-0.07	-0.16	-0.18	-0.20
Abolish Savings Rebate		0.79	2.04	2.14	2.24
Fringe Benefits Tax (c)		0.00	0.72	0.76	0.78
Income tax effect of other policy measures nei (d)		0.00	0.00	0.24	0.26
	Total	0.72	-11.69	-11.86	-12.78
Business tax					
Consistent treatment of entities					
Trusts		0.07	0.90	0.76	0.43
Deferred company tax		0.07	0.19	0.39	0.42
Refundable imputation credits		0.00	0.00	-0.55	-0.55
Life insurers		-0.02	0.59	0.67	0.65
Share buy-backs and liquidations		0.00	0.00	-0.30	-0.30
	Total	0.12	1.67	0.97	0.65
Administration					
Company payment arrangements		0.21	2.35	2.60	2.42
Abolition of provisional tax (e)		0.00	-1.44	0.00	-0.92
Enhanced compliance		0.00	0.80	1.43	1.35
	Total	0.21	1.72	4.03	2.86
Indirect tax					
WST abolition (f)		-0.56	-15.32	-17.75	-18.75
Petrol excise (g)		0.00	0.44	0.48	0.50
Diesel excise (g)		0.00	0.33	0.35	0.37
Alcohol excise (g)		0.00	1.22	1.27	1.30
Tobacco excise (g)		0.25	3.16	3.22	3.22
Luxury car tax		0.00	0.18	0.21	0.21
Wine Equalisation Tax		0.00	0.60	0.70	0.72
	Total	-0.31	-9.39	-11.53	-12.42

Revenue measures table: the complete package* (continued)

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Other revenue				
Receipts from States for GST administration (h)	0.00	0.70	0.30	0.29
Growth dividend - Commonwealth's share	0.00	0.35	0.55	0.70
Total	0.00	1.05	0.85	0.99
Outlays				
Reduction in Financial Assistance Grants	0.00	18.18	18.81	19.46
New States' responsibility toward local governments	0.00	1.34	1.38	1.43
Increased assistance for social security recipients (i)	0.00	-1.79	-1.65	-1.72
Delivery of half of family package (a)	0.00	-1.16	-1.22	-1.28
Aged Persons Savings Bonuses	0.00	-1.30	0.00	0.00
Reduction in pension taper rate	0.00	-0.38	-0.40	-0.42
Tax rebate/benefit for private health insurance (b)	-0.95	-1.02	-1.09	-1.16
Fringe Benefits Tax (c)	0.00	0.01	0.03	0.03
Replacement of Diesel Fuel Rebate Scheme	0.00	1.59	1.70	1.79
Diesel fuel rebate for remote power	0.00	-0.01	-0.01	-0.01
Diesel credits administered through GST	0.00	-3.58	-3.84	-4.05
GST policy/administration costs	-0.35	-0.35	-0.30	-0.29
GST business startup package	-0.50	0.00	0.00	0.00
Grants to balance State budgets (j)	0.00	0.00	-0.94	-0.32
Reduced costs to government from indirect tax reform (k)	0.00	0.54	0.57	0.60
Total	-1.80	12.07	13.04	14.06
Public debt interest	-0.10	-0.18	-0.30	-0.60
Impact on underlying Commonwealth budget (l)	**-1.16**	**-4.76**	**-4.80**	**-7.25**

Revenue measures table: the complete package* (continued)

States, Territories and local government	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
GST				
GST revenue (m)	0.00	27.20	31.96	32.81
Taxes abolished/reduced				
Reduced gambling taxes	0.00	-0.48	-0.56	-0.59
Abolition of FID/debits tax	0.00	-0.97	-2.39	-2.46
Abolition of business stamp duties	0.00	0.00	-2.33	-2.41
Abolition of accommodation taxes	0.00	-0.08	-0.06	-0.06
Abolition of business franchise fee replacement taxes	0.00	-6.65	-7.04	-7.24
Total	0.00	-8.19	-12.38	-12.76
Other revenue				
Reduction in Financial Assistance Grants	0.00	-18.18	-18.81	-19.46
Commonwealth grants to balance State budgets (j)	0.00	0.00	0.94	0.32
Growth dividend - States' share	0.00	0.20	0.30	0.40
Total	0.00	-17.98	-17.57	-18.74
Outlays				
New States' responsibility toward local governments	0.00	-1.34	-1.38	-1.43
First Home Owners' Scheme	0.00	-0.81	-0.83	-0.85
Reduced costs to government from indirect tax reform (k)	0.00	0.54	0.57	0.60
State rebates for off road diesel	0.00	0.58	0.63	0.66
Payments to Commonwealth for GST collection (h)	0.00	-0.70	-0.30	-0.29
Total	0.00	-1.72	-1.32	-1.31
Impact on State, Territory and local government budgets (l) (n)	**0.00**	**-0.69**	**0.69**	**0.00**

Revenue measures table: the complete package* (continued)

- * A positive revenue or outlays number implies a positive impact on the budget balance.
- (a) The family package consists of measures which affect both revenue and social security outlays.
- (b) The tax rebate/benefit for private health insurance has a start date of 1 January 1999. It influences both revenues and outlays and is estimated to have a part year budgetary cost of around $330m in 1998-99. The fiscal impact includes the removal of the existing Private Health Insurance Incentive Scheme and the impact on health outlays of the new initiative.
- (c) The proposal to include fringe benefits on group certificates will influence revenues and social security outlays. It commences with respect to the 1999-00 FBT year.
- (d) Includes income tax effect of abolition of FID/debits tax, reduced pension taper rate and increased social security assistance.
- (e) Revenue impact of moving provisional tax payers onto the new pay as you go scheme.
- (f) Includes abolition of wholesale sales tax, collection of outstanding wholesale sales tax debt, the wholesale sales tax phase down in 1999-00 and response effects associated with replacing the wholesale sales tax with a GST.
- (g) Refer to reconciliation tables at the end of Chapter 2 for more detail on this measure.
- (h) The payment in 2000-01 reflects costs associated with GST administration incurred in 1999-00 and 2000-01.
- (i) Includes one and a half per cent real increase.
- (j) Payments to States to offset negative early year impacts of GST implementation.
- (k) This reflects the removal of embedded wholesale sales tax and excises on purchases by Australian governments.
- (l) The Commonwealth will provide a one year interest free loan to the States to offset the increase in their net financing requirement that arises in 2000-01 as a result of early year impacts of GST implementation. As a consequence of this arrangement, the net financing requirement of the States is unaffected by tax reform in each of the years 1999-00 to 2002-03. The impact on the headline balance for the Commonwealth is -$1.16 billion in 1999-00, -$5.45 billion in 2000-01, -$4.12 billion in 2001-02 and -$7.25 billion in 2002-03. The public debt interest costs associated with the loan are included in the Commonwealth public debt interest item.
- (m) Includes GST revenue, the phased input credit on motor vehicles, credit for wholesale sales tax paid stock, and response effects associated with replacing the wholesale sales tax with a GST.
- (n) Tax reform is projected to make a positive contribution to the net budgetary position of the States and local government in 2003-04 of around $0.37 billion. Beyond 2003-04 real per capita incomes will result in faster growth in indirect tax revenues than in the Commonwealth grants being abolished.

Incentive
Reforms to income tax and social security

Overview

The personal income tax and social security systems are complex and reduce incentives to work and save, particularly for low and moderate income families.

Income tax rates are being reduced, assistance for families is being increased and reformed and income support payments increased. The structure of both systems is being simplified — especially as it affects families.

Reform will increase incentives and make the system easier to understand.

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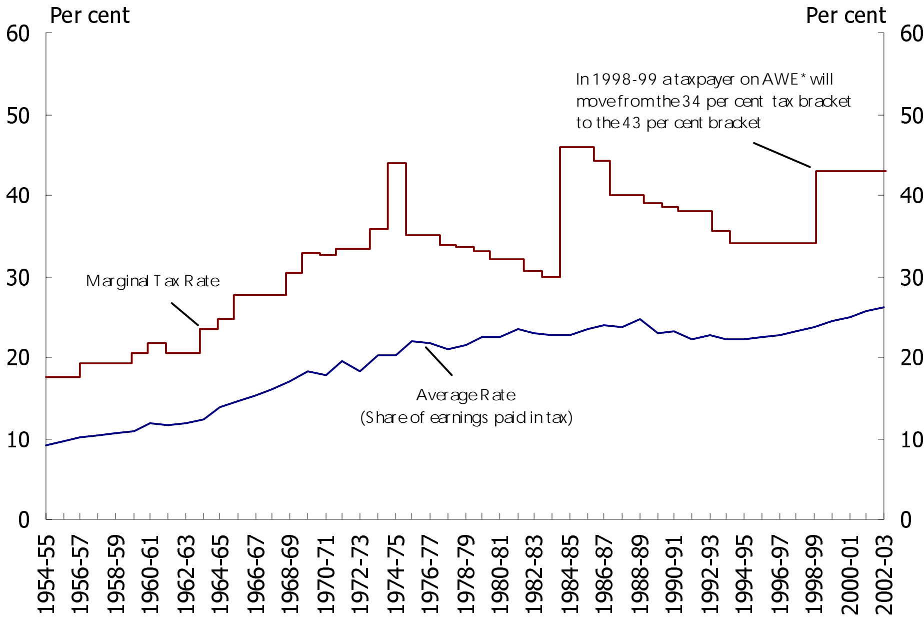
The problem

Income tax and social security arrangements destroy incentives

Income tax rates are too high. Twelve months ago, a person on average earnings paid tax of 34 cents for each additional dollar they earned. Today, the figure is 43 cents. Within a few years it will rise to 47 cents, unless something is done. The average tax rate — the amount of income tax that people pay as a percentage of their income — has also been increasing for middle income earners over the past 40 years.

These trends are illustrated in Figure 1.1 below. The average tax rate paid by middle income earners has increased steadily. The marginal tax rate — the tax payable on an extra dollar of income — has also trended up.

Figure 1.1:
Average and marginal rates for those on average earnings are increasing

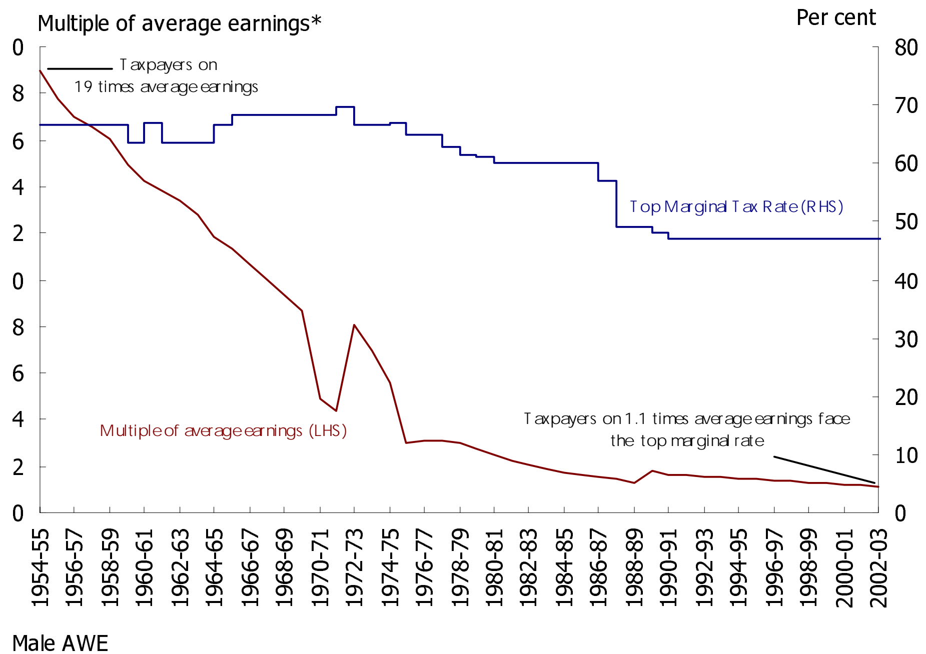


* Male AWE

The Government is committed to maintaining a progressive income tax system so that those in a position to make a relatively greater contribution to raising revenue do so. However, the current system means that many moderate income taxpayers are now paying, or soon will be paying, the top marginal tax rate of 47 cents in the dollar, which takes effect from incomes of $50,000 a year. In 1954-55, the top marginal

tax rate was paid by a taxpayer who earned 19 times average earnings. By 1999-00, under the current system, it is estimated that the top rate will be paid by a taxpayer earning 1.2 times average earnings and will fall to 1.1 times average earnings by 2002-03. This is further illustrated in Figure 1.2. It contributes to an unfair income tax system that penalises incentives to work and save.

Figure 1.2:
Average earners are approaching the top marginal rate



These problems have come about for several reasons. In the absence of a comprehensive indirect tax system, the personal income tax system has been required to shoulder a greater share of the revenue raising load than would otherwise be the case. This results in higher tax rates for all taxpayers.

Furthermore, the high income tax rates associated with this imbalance provide greater incentives for individuals to undertake aggressive tax planning. This leads to an even more fragile and narrow revenue base, requiring higher tax rates to raise the revenue needed to provide government services.

But these high marginal tax rates create disincentives for people to:

- undertake extra work or seek advancement;
- undertake additional education or training, as the after-tax rewards of a higher skilled/higher paying job are reduced; and
- increase personal savings, as the returns to saving are also subject to high marginal tax rates.

Low and middle income families are especially disadvantaged

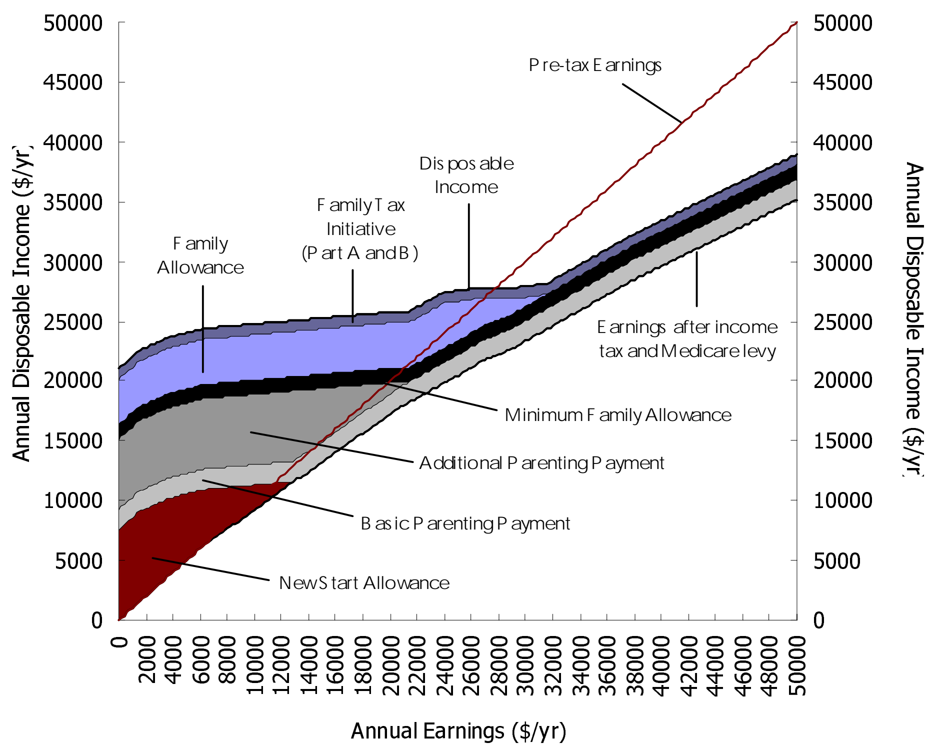
These effects are compounded when the social security system is also taken into account.

It is a commonly held view that the highest marginal tax rates are paid by people at the top end of the income distribution. However, the interaction between the income tax and social security systems means that many low and moderate income families keep only a few cents of each additional dollar that they earn. In some instances, these families can actually go backwards — that is, experience a reduction in disposable income — as their earned income goes up.

This is the area where work disincentives bite the hardest. It is essential that the tax and social security systems not stand in the way of low and moderate income working families who want to work harder to improve their standard of living. Work choice should not be driven by the disincentives created by the current interaction of the tax and social security systems.

The impact of the current work disincentives and the net financial return from working for a single income family with two children aged 4 and 7 years under the current system is illustrated in Figure 1.3. Without any earnings, the family receives social security and family payments totalling just over $21,000. Disposable income increases only slowly as earnings increase, because tax is paid but, more significantly, social security and family payments are withdrawn. For some low income working families, the effective marginal tax rates are 85.5 per cent or more because they pay tax of 34 cents, Medicare levy of 1.5 cents and they lose family payments at a rate of 50 cents for each extra dollar of income that they earn.

Figure 1.3:
Disposable income for families increases slowly as earnings increase, up to earnings of $32,000 a year



The return from additional work is not sufficient

Richard and Fiona have two children, Julie and Jack aged 7 and 4 years. Richard is unemployed and works casual shifts at the local pub, earning $120 a week. The pub owner has offered Richard a full-time position. If Richard accepts the position, paying $420 a week, the family's disposable income will increase by less than $47 a week, because they will lose some social security and family benefits, as well as pay more tax. Overall, the family keeps only 15 cents of every extra dollar of income that Richard earns.

After working for a year Richard is considering undertaking a TAFE course to improve his chances of gaining a job as a bar manager. The position pays a salary of $33,000 a year ($635 a week). But if Richard takes the position the family income will increase by less than $47 a week. He gets to keep only 22 per cent of his increased earnings.

This example understates the lack of incentives for low income families. First, some families can actually go backwards as their income increases. For example, a single income couple family with two children faces an effective tax rate of 105 per cent between $27,600 and $29,600 a year of private income. In addition, for unemployed people, entering the

workforce brings additional work related costs. They can also lose access to a considerable range of non-cash benefits that are withdrawn when people enter the full-time workforce.

These disincentive effects are largely a consequence of a targeted social security system which focusses assistance on those most in need. To target such assistance on low income families, benefits must be withdrawn as income increases — but this reduces the amount of money that people effectively keep out of their earned income. While targeting is essential in order to direct assistance to those in greatest need and to contain costs, it can reduce work incentives. The tax and social security systems need reform to get a better balance between targeting and enhancing work incentives.

Some people don't pay their fair share

High marginal rates encourage tax minimisation

As well as reducing work incentives, high marginal tax rates provide incentives for people to take advantage of opportunities to reduce their tax liabilities. This fosters the perception (often real) that some people are not paying their fair share of the tax burden or are exploiting the social security system.

Such practices are used not only by the very wealthy. With the top marginal rate of 47 per cent taking effect at $50,000 a year, people earning not much more than average earnings can gain considerably by reducing their taxable income through the use of legal tax minimisation schemes like trust structures and other forms of financial planning.

The poor return from extra effort for low and moderate income earners (discussed above) also creates incentives for people to avoid or evade tax and cheat on the social security system by working in the underground economy.

Salary sacrifice is used to lower tax, access social security and avoid Government surcharges

A major problem in this area is the rapidly expanding practice of salary sacrificing — taking a portion of salary in the form of fringe benefits, such as a car. By converting some salary to non-salary fringe benefits, a taxpayer can retain access to some social security entitlements, such as Family Allowance, because of the limited coverage of fringe benefits in the income tests for such entitlements. Depending on the income level, other elements of the tax and social security systems, such as the Medicare surcharge, Superannuation Contributions Surcharge and child support liabilities, can be avoided or reduced.

Such practices undermine the fairness of the tax system. Moreover, they mean that other taxpayers have to pay more to make up for the revenue that is lost. Put simply, some employees have no options for salary sacrificing, while others are provided with a menu of salary package options and choose the ones that are best for their individual circumstances. Such unfairness in the system needs to be addressed.

The income tax/social security system is too complex

The systems have not been integrated

The tax and social security systems have become extremely complex over the last decade or so. There are currently over 30 major types of income support payments and supplements. Some of these are taxable, others are non-taxable and the tax status of some depends on the characteristics of the recipients. In addition, tax liability is affected not only by the tax scale and the Medicare levy, but also through a myriad of rebates and possible deductions.

This complexity is the result of tighter targeting of the social security system over time, the changing structure of society, the need to close loopholes and the ability of different groups to obtain preferential treatment. The tax system has also undergone both major and minor change over this period for similar reasons.

The complexity increases further when the combined effect of the two systems is examined. The interaction between them needs to be simplified to make them easier to understand and deliver to the Australian people.

Family assistance is a classic example of complexity

This complexity is most evident in the current assistance provided to families. Table 1.1 details the major forms of government assistance to families through the income tax and social security systems, apart from those (such as Newstart Allowance or Parenting Payment) which provide income support where family income is low.

Table 1.1:
Family assistance is delivered in a piecemeal fashion

Assistance through outlays	Assistance through the tax system
Minimum Family Allowance	Family Tax Assistance Part A
Family Allowance	Dependent Spouse Rebate
Family Tax Payment Part A	Sole Parent Rebate
Guardian Allowance	Family Tax Assistance Part B
Basic Parenting Payment	
Family Tax Payment Part B	
Child Care Assistance	
Childcare Cash Rebate	

A number of these forms of assistance have virtually identical objectives:

- Minimum Family Allowance, Family Allowance, Family Tax Payment Part A and Family Tax Assistance Part A are all provided to assist families with the direct costs of raising children;
- Basic Parenting Payment, Guardian Allowance, Family Tax Payment Part B, the Dependent Spouse Rebate, Family Tax Assistance Part B and the Sole Parent Rebate are provided to assist single income families, including sole parents; and
- Child Care Assistance and the Childcare Cash Rebate are provided to assist families with the costs of childcare outside the home.

This array of assistance is confusing for Australian families, requiring them (or their advisers) to navigate their way through a maze of different and complex eligibility criteria, different income tests and different delivery mechanisms in order to obtain assistance.

In some cases, families need to choose whether it is more advantageous to them to claim essentially the same form of assistance through the tax system or the social security system, with the risk that they don't get their full entitlement because of the complex and different rules applied to assistance through each system.

There is a need to simplify the structure and delivery of assistance for families. The number of programmes could be reduced substantially with only one payment dealing with each target group and their delivery being made through one agency.

The goal

Incentives to work and save

We need to put in place a coherent income tax and social security system for the twenty-first century. We need a system to ensure that all Australians — especially low and moderate income families — have much stronger incentives to work and save.

A fair and simple system

The community's faith in the personal income tax and social security systems, and therefore their sustainability, must be restored by implementing:

- a system that is simple and transparent, where income support and family payment entitlements are clearly understood and easily dealt with; and
- a system in which people pay their fair share and do not have access to loopholes.

The strategy

The Government's reform of the personal income tax system and the social security system is being undertaken on three fronts.

Lower tax rates for all Australians

To address the problems associated with low work incentives for all Australians, income tax rates are being cut and thresholds improved.

To make the tax system fairer for all taxpayers, reforms are also being made to Fringe Benefits Tax (FBT) arrangements.

Reform of family assistance

To help families raise their children, assistance for them is being increased, work incentives for low and middle income families are being improved and the structure and administration of family assistance is being revamped to simplify it.

Increased social security payments

To ensure that the gains of tax reform are shared widely, pensions and benefits are being increased in real terms and the pension income test is being eased to improve work and savings incentives.

The plan

Lower income tax rates

The Government's reforms of the income tax system provide tax cuts across-the-board, with reductions in marginal tax rates for about 95 per cent of all taxpayers.

Table 1.2 shows the current income tax scale and the one that will take effect from 1 July 2000.

Table 1.2:
Income tax scale

Current scale*		New scale	
Taxable income	**Tax rate (%)**	**Taxable Income**	**Tax rate (%)**
0-5,400	0	0-6,000	0
5,401-20,700	20	6,001-20,000	17
20,701-38,000	34	20,001-50,000	30
38,001-50,000	43		
50,001+	47	50,001-75,000	40
		75,001+	47

* In addition, the $150 low income rebate applies to both the current and new scales.

The key features of the new tax scale are:

- an 11 per cent increase in the tax free threshold to $6000 which is worth up to $120 a year in reduced tax. This helps all taxpayers but is of relatively greater benefit to low income taxpayers;
- a reduction in the lowest marginal tax rate from 20 per cent to 17 per cent. This, too, helps all taxpayers but is of particular benefit to low income taxpayers;
- large tax cuts for middle income earners with income between $30,000 and $50,000 a year through the replacement of the 34 per cent and 43 per cent tax rates with a 30 per cent rate:
  - — this will mean that around 81 per cent of taxpayers will have a top tax rate of 30 per cent or less, compared to around 30 per cent of taxpayers currently;

— a single taxpayer earning $30,000 a year will receive a tax cut of $842 a year or $16 a week, representing a 3.6 per cent increase in after tax income;

— a person on projected average earnings of $45,000 in 2001-02 will receive a tax cut of $2,072 a year or $40 a week, representing a 6.4 per cent increase in after tax income; and

- a $25,000 increase (to $75,000) in the level of income at which the top marginal rate of 47 per cent takes effect. The $75,000 threshold will be equal to around 1.7 times average earnings. This will ensure that average earners do not drift into paying the top marginal tax rate, which would otherwise have occurred early in the next century.

Table 1.3 shows the tax cuts for various levels of taxable income.

Table 1.3:
Amount of tax cuts

Taxable income	Tax cut $ per year	Tax cut $ per week	% change in tax payable
$6,000	120	3.45	-17.4
$20,000	540	10.36	-17.6
$30,000	842	16.15	-12.6
$40,000	1,422	27.27	-13.7
$50,000	2,722	52.21	-18.3
$60,000	3,422	65.63	-17.4
$75,000	4,472	85.77	-16.6
$85,000	4,472	85.77	-14.1
$90,000	4,472	85.77	-13.1
$100,000	4,472	85.77	-11.4

These income tax cuts, totaling over $13 billion a year, provide a 14 per cent reduction in total personal income tax collections. They will break the historical trend of increases in the average tax rate for average earners, shown earlier in Figure 1.1.

Low and middle income taxpayers, in particular, will keep a higher proportion of the earnings they receive after tax, providing them with greater rewards for their work efforts and improved incentives to better their financial position through overtime, promotion and training.

In view of the major impact that the across-the-board reductions in tax rates will have on incentives to work and save, and in view of the cut in marginal tax rates on saving, the savings rebate will be terminated with effect from 1999-00.

Further details of the benefits of the income tax cuts being provided to individuals and families are provided in Chapter 5.

Private health insurance initiative

In order to assist families and individuals with the cost of private health insurance, a new 30 per cent tax rebate/benefit will be introduced from 1 January 1999. It will not be means tested and will be at a rate of 30 per cent of expenditure on private health insurance, including ancillary cover.

The new tax rebate/benefit will be available in addition to the existing medical expenses rebate and can be received as a tax rebate or as a direct payment from the Government.

Under the new tax system, the new tax rebate/benefit is as generous or more generous than full income tax deductibility for health insurance premiums for more than 80 per cent of taxpayers.

The Family Assistance Office (described later in this chapter) will administer the tax rebate/benefit. Taxpayers will be able to claim the rebate on assessment. Alternatively, the Government will ensure that a direct payment can be claimed from an extensive network of shopfronts or arranged through the mail.

Those families and individuals who pay for private health insurance through a single premium payment can seek the benefit as a payment by providing proof of purchase to the Family Assistance Office. For those who pay for their insurance by instalment, the benefit will also be available by instalment.

The new tax rebate/benefit will replace the existing Private Health Insurance Incentive Scheme (PHIIS). The PHIIS will continue to operate up to the introduction of the new rebate/benefit, with PHIIS recipients entitled to part year assistance in respect of 1998-99.

The increased level of assistance to private health insurance members provided under the new tax rebate/benefit, and the broader access to the incentive, are expected to lead to a significant increase in private health insurance membership.

Reforming the Fringe Benefits Tax provisions

The Government is reforming the Fringe Benefits Tax (FBT) provisions to make the system fairer for all taxpayers.

The reforms have four elements:

- improving income tests for surcharges and government benefits by requiring employers, from the 1999-00 FBT year of income, to identify on group certificates the grossed-up taxable value of an employee's fringe benefits that are part of their remuneration package or award, where the value of the benefits exceeds $1,000:

  - while tax liability for such benefits will remain with the employer (under FBT), their value will be included as income for determining liability for tax surcharges (such as the Medicare levy surcharge and the superannuation contributions surcharge) and income related obligations such as child support;
  - the non-grossed-up amount for a wider range of fringe benefits will also be included in assessing entitlement to certain income-tested government benefits (ie Family Allowance and the parental income test for Youth Allowance);

- stopping overuse of the concessional FBT treatment of public benevolent institutions and certain other not-for-profit organisations. This will be done by limiting, for each employee, the value of fringe benefits eligible for concessional treatment to $17,000 of grossed-up taxable value per employee of such organisations (equivalent, in broad terms, to the grossed-up value of an average 6 cylinder car and some additional minor benefits). Any amount above this limit will be subject to the normal FBT treatment;
- extending FBT to benefits in excess of $1,000 a year provided by companies to their shareholders or by trustees to trust beneficiaries, where the benefits are not taxed currently; and
- extending the FBT exemption for remote area housing provided by mining industry employers to their employees. This provides the mining industry with the same treatment that applies currently to primary producers.

The last three measures will take effect from the 2000-01 FBT year.

In addition, the FBT gross-up rate will be changed to ensure neutrality of treatment between fringe benefits and cash salary following the introduction of the GST. The new gross-up rate will take effect from July 2000.

Improving assistance for families

To accompany the changes to the personal income tax system, the Government will introduce substantial reforms to the various forms of assistance provided to families through the income tax and social security systems.

These reforms will provide extra assistance to families in recognition of the extra costs involved in bringing up children and the sacrifices that families make. They boost the amount of the income tax cuts that families receive, substantially improve work incentives for low and middle income families and greatly simplify the complex array of assistance provided currently to families.

Increasing the amount of assistance

Extra assistance is provided to families by extending the Family Tax Initiative (FTI), introduced by the Government in January 1997, at a cost of over $2 billion in 2000–01.

The FTI currently provides an increase in the tax free threshold of $1,000 for each dependent child, plus an extra $2,500 for single income families with a child aged under 5 years. From 1 July 2000, these thresholds will be doubled to $2,000 and $5,000 respectively.

The effect of this is that all single income families (including sole parents) with a child under 5 years will have an effective tax free threshold of $13,000. This is made up of the new $6,000 tax free threshold plus $2,000 for one dependent child and the further $5,000 provided to single income families with young children. Overall, such families have a tax free threshold that is more than double the general $6,000 threshold.

For families, the doubling of the FTI means:

- an increase in assistance of $140 a year (a 70 per cent increase) for each dependent child; and
- on top of this, an extra $350 a year (a 70 per cent increase) for single income families with a child aged under 5 years.

Table 1.4 shows the increases in assistance for different types of families from July 2000 and the total increase in assistance that will have been provided since January 1997 when the Government introduced the FTI.

Table 1.4: Family Tax Initiative will be increased in July 2000

Family type	Increase in assistance ($/yr)	
	From July 2000	Including increase in January 1997
Single-income family		
one child under 5 years	490	1,190
2 children, one under 5 years	630	1,530
2 children, aged 5 years or more	280*	680*
3 children, one under 5 years	770	1,870
3 children, aged 5 years or more	420*	1,020*
Dual-income family		
one child	140	340
two children	280	680
three children	420	1,020

* Single income families with a youngest child aged 5-16 years receive an extra $61 a year from other elements of the families package. See page 54 for details.

Improving incentives for families to work — including the unemployed

The current system of assistance for families, particularly the overlap between the various income tests for benefits, results in disincentives for low and moderate income families to work. Many families face an effective marginal tax rate of 85.5 per cent or more if they increase their income.

To remove these overlaps and disincentives, the Government will, from July 2000, ease substantially the income test for Family Allowance by:

- increasing the level of income at which it begins to be income tested from $24,350 a year (for one child) to $28,200 a year; and
- reducing the income test taper rate from 50 per cent to 30 per cent.

These measures represent a major social reform that provides substantial extra income to help lower income families raise their children and improves work incentives. They ensure that unemployed families will not incur a sudden drop in Family Allowance (and hence income) when they leave the income support system, improving incentives for them to obtain a full-time job.

At the same time, these measures, combined with the tax cuts, will ensure that low income working families will have much better incentives to improve their circumstances. For example, their effective marginal tax rate will drop from 85.5 per cent to 61.5 per cent over a substantial range of income. As outlined in the example below, low and moderate income families will get to keep considerably more income than is currently the case.

The increase in work incentives

Recall Richard and Fiona, with the two children, Julie and Jack (see earlier in this chapter). Following the reform to tax rates and family assistance, the return from working has been significantly increased.

Under the current system, a move from part-time to full-time work netted Richard an extra $47 a week. In the reformed system this amount increases to $70 a week — an increase of more than 50 per cent in the amount of the pay rise that he takes home. If Richard gains the promotion to bar manager, he keeps a further $74 a week of his higher pay after tax reform. This is $27 a week more than would have been kept under the current tax and social security systems. As a result of tax reform, there is an extra $4,102 a year in the family's pocket.

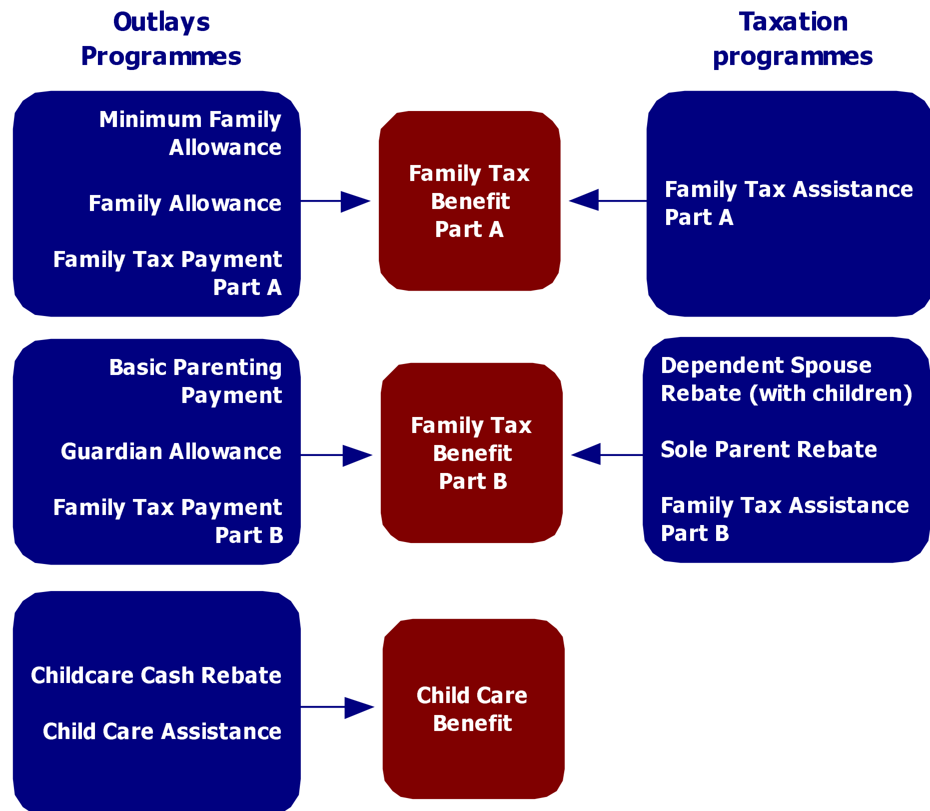
Simplifying the structure and delivery of Family Assistance

Building on these increased levels of assistance and greater work incentives for families, the Government proposes to greatly simplify the

structure of assistance for families, with effect from July 2000. Prior to implementation, the Government will consult with community organisations on the details of the new structure.

The new structure will reduce the types of assistance for families through the tax and social security systems from twelve to three. This is shown in Figure 1.4.

Figure 1.4:
Twelve family benefits simplified to three



Family Tax Benefit, Part A

First, it is proposed that the four forms of assistance provided to help families with the costs of raising children will be merged into one benefit, the Family Tax Benefit, Part A (FTB(A)). This will:

- have the same rate structure as the programmes it replaces (ie maximum and minimum rates), but with the extra $140 a year for each dependent child outlined above;
- use the relaxed income test for Family Allowance outlined above for the maximum benefit (ie a threshold of $28,200 a year and a 30 per cent taper rate);
- replace the 'sudden death' income tests for minimum Family Allowance, Family Tax Payment (FTP) and Family Tax Assistance (FTA) with a single relaxed income test for the minimum FTB(A) of $73,000 a year (plus $3,000 a year for each child after the first) and a taper rate of 30 per cent;

- abolish the assets test that applies currently to Family Allowance and minimum Family Allowance; and
- be increased annually in line with movements in the Consumer Price Index (CPI) in the same manner as applies currently for Family Allowance.

Family Tax Benefit, Part B

Second, it is proposed that the six forms of assistance provided to single income families (including sole parents) will be merged into a Family Tax Benefit, Part B (FTB(B)). This will:

- have a similar rate structure to the current system (ie with the level of assistance being higher where the youngest child is aged less than 5 years), but with
  - — the additional $350 a year for single income families (including sole parents) with a child under 5 years outlined above;
  - — an additional $61 a year, where the youngest child is aged 5-16 years, meaning that a single-income family with two children aged over 5 years receives an additional $341 a year comprising $280 as set out in Table 1.4 plus an additional $61;
- for couples, replace three different income tests on the non-working partner's income with one test that has a free area of $1,616 a year and a 30 per cent taper (thereby increasing the cut-out point for assistance from $6,090 a year to $10,500 for a family with a child aged under 5 years):
  - — this will greatly improve work incentives for primary carers (who are usually women);
- abolish the FTA/FTP income test on the working partner's (or sole parent's) income that applies currently from $65,000 a year; and
- be indexed annually in line with movements in the CPI in the same manner as applies currently to Family Allowance.

Child Care Benefit

Third, it is proposed that the two forms of assistance available to help families with the costs of childcare outside the home will be merged into one. The new benefit will greatly simplify government assistance for childcare costs, enabling families to receive all assistance with childcare through the one programme and under one set of rules. The Child Care Benefit will provide:

- maximum assistance (for 50 hours of work-related care per week) of $116.40 a week per child in formal care, with an additional $11 a week loading where there are 2 children in care and a $32 a week loading for 3 or more children in care;
  - — for informal work-related care, the maximum level of assistance is $20.10 a week per child in care (for 50 hours of care);

- a single income test, with a family income threshold of $28,200 a year (for formal care) and taper rates of:
  - — 10 per cent for one child in care;
  - — 15 per cent and (above $66,000) 25 per cent for 2 children in care;
  - — 15 per cent and (above $66,000) 35 per cent for 3 or more children in care;
- the income test will not apply for incomes above $78,400 (one child in care). This will, in effect, maintain entitlements to assistance (equivalent to that available under the Childcare Cash Rebate at the 20 per cent rate) for higher income families.

Compared to the current system, the Child Care Benefit will provide an increase in the maximum level of assistance of $7.50 a week. This will be of particular benefit to 200,000 lower income families, who receive the maximum level of assistance.

Further detail on the new, simplified structure is provided at the end of this chapter.

Delivery of family assistance

The Government's reform of family assistance will also simplify and integrate the delivery of such assistance to Australian families.

Currently, the 12 forms of assistance for families outlined in Figure 1.4 are delivered through a combination of Centrelink, the Tax Office and the Health Insurance Commission. This is inefficient. But more importantly, it is confusing for families, making it very difficult for them to understand the range of assistance available to them, to easily access their entitlements and to deal with the myriad sets of rules and regulations used by each organisation.

To break out of this maze, a new Family Assistance Office (FAO) will be set up within the Tax Office to deliver the new simplified set of family assistance programmes. The FAO will be a joint venture between Centrelink and the Tax Office that will specialise in delivering assistance to families. It will enable families to deal with just one agency and one set of rules. The primary carer in the family (generally the mother) will have a choice as to how they wish to receive their assistance — either through regular fortnightly payments to their bank account, as reduced tax deductions from their (or their partner's) pay-packet or as an end-of-year lump sum through the tax system.

Providing extra assistance for social security recipients and other lower income groups

A fundamental objective of the Government's tax reform package is to provide a tax system that is fairer for all Australians. Many lower income individuals and families will benefit from the new income tax scale and the family assistance package. However, some low income groups, such as age pensioners with no private income, do not pay income tax currently and, hence, cannot benefit from the Government's tax cuts.

Increasing pensions and benefits

To ensure that such groups receive their fair share of the benefits of tax reform, the Government will increase the adequacy of all social security and veterans' pensions and other income support payments and allowances, with effect from July 2000. The payments that will increase are listed on the next page.

It is estimated that by 2001-02 the overall impact of the tax package will have added 1.9 per cent to the CPI, excluding new house prices (which will be compensated by a new First Home Owners' Scheme) and tobacco. But because not all of the indirect tax cuts commence in 2000-01, the CPI impact in that year is likely to be a little higher — perhaps as much as half a percentage point. In order to ensure that no pensioner or beneficiary is disadvantaged by this, the Government will provide from July 2000:

- a 4.0 per cent increase in the maximum rate of all income support payments provided to social security and veterans' pensioners, other social security recipients and students in receipt of Commonwealth income support, including additional payments and allowances such as Child Disability Allowance and Mobility Allowance; and
- a 2.5 per cent increase in the income test free areas applied to social security, veterans' and student income support payments.

These increased rates of assistance raise the maximum level of all income support payments by more than the impact of tax reform on prices (as measured by the CPI), overcompensating recipients for the cost of living effects of the changes to indirect taxation arrangements. The Government will ensure that income support payments are 1.5 per cent higher than they would have been had the normal automatic indexation arrangements applied. This represents an estimated real increase of $5.80 per fortnight in the maximum single rate pension and $4.80 per fortnight for each of a married couple in July 2000. In addition, the Government will continue to ensure that the single rate of pension does not fall below 25 per cent of male total average weekly earnings.

Commonwealth income support payments

Payments increasing

The following government payments will increase as part of ensuring that all Australians benefit from the new tax system:

- Age pension
- Age service pension
- Disability support pension
- Invalidity service pension
- Wife pension
- Partner service pension
- Widow Class B pension
- Carer payment
- Carer service pension
- Veterans' income support supplement and veterans' dependents pension
- Adequate means of support pension
- Disability pension — general rate, intermediate rate, special rate (TPI and TTI) and extreme disablement adjustment
- War widow's/widower's pension
- Mature age allowance and mature age partner allowance
- Sickness allowance
- Newstart allowance
- Youth allowance
- Partner allowance
- Bereavement allowance, Veterans' bereavement payment and Veterans' funeral benefit
- Special benefit
- Parenting payment
- Widow allowance
- Maternity allowance (including maternity immunisation allowance)
- Double orphan pension and veterans' orphan pension
- Child disability allowance
- Domiciliary nursing care benefit
- Mobility allowance
- Remote area allowance
- Telephone allowance
- Veterans' allowances (attendant allowance, clothing allowance, decoration allowance, loss of earnings allowance, recreation transport allowance, temporary transport allowance and Victoria Cross allowance)
- Rent assistance
- Austudy (all elements)
- Abstudy (all elements)
- Veterans' children education scheme
- Assistance for isolated children scheme (all elements)
- Education entry payment
- Employment entry payment
- Pharmaceutical allowance
- Pensioner education supplement
- New Enterprise Incentive Scheme
- Drought relief payment

Note: Payments for families not included above will be increased as part of the family package.

Easing the pension income test

The income test for pension payments will also be eased, with effect from July 2000, by reducing the taper rate from 50 per cent to 40 per cent. This will assist all 845,000 part-rate pensioners by enabling them to keep an extra 10 cents of pension for every dollar of private income they receive above the income test free areas. It will be of particular benefit to age and service pensioners and to self-funded retirees with modest incomes who will become eligible for a part-rate pension as a result. More broadly, the measure will improve incentives to save for retirement by increasing the returns from such saving at the time that people retire. The measure will also improve work incentives for sole parent pensioners.

Introducing an Aged Persons Savings Bonus and Self-Funded Retirees Supplementary Bonus

In addition, the Government will provide special payments to older Australians — pensioners and self-funded retirees — with income from savings. The Aged Persons Savings Bonus and Self-Funded Retirees Supplementary Bonus will help maintain the value of the savings and retirement income of older people.

The maximum value of the Aged Persons Savings Bonus will be $1,000 per person while the Self-Funded Retirees Supplementary Bonus will provide up to an additional $2,000 per person to eligible people who are of age pension age but not in receipt of a social security or service pension. This additional amount will assist self-funded retirees who will not benefit from the increases in the maximum rates of age and service pensions.

These bonuses will:

- provide an untaxed Aged Persons Savings Bonus of up to $1,000 to each Australian resident aged 60 or more on 1 July 2000 with personal income from savings and investment (including superannuation pensions and annuities) and whose total income in 1998-99 or 1999-00 is less than $30,000;
- provide an additional untaxed Self-Funded Retirees Supplementary Bonus payment of up to $2,000 to each eligible person of age pension age but not in receipt of a social security or service pension, representing a lump sum payment in lieu of an income supplement of $200 a year for ten years;
- be calculated on the basis of $1 of Bonus payable for each $1 of income from savings and investments (including superannuation pensions and annuities) in 1998–99 or 1999-00, up to the maximum amounts;

- be targeted to lower income groups with taxable incomes less than $20,000 in 1998-99 (or 1999-00), phasing out between $20,000 and $30,000 at a rate of 10 cents in the dollar on taxable income in excess of $20,000 for the $1,000 payment and 30 cents in the dollar for the combined $3,000 payment; and
- be paid from July 2000.

The Aged Persons Savings Bonus and
Self-Funded Retirees Supplementary Bonus

Geoff and Margaret are age pensioners. Geoff has a taxable income of $10,000 a year, of which $1,500 is investment income. Margaret has a taxable income of $7,000 a year, of which $1,000 is investment income. Geoff will be entitled to a Bonus of $1,000. Margaret will also be entitled to a $1,000 Bonus.

Gwendolyn is single, aged 62 and not receiving a Government pension. She has a taxable income of $25,000 a year, of which $5,000 is investment income. She will be eligible for a combined maximum bonus of $3,000 on her investment income. This will be reduced by 50 per cent because her total taxable income exceeds $20,000 by $5,000. This provides her with a $1,500 entitlement.

Increasing tax rebates

Further assistance for older Australians will be provided by an increase in the maximum Pensioner Tax Rebate and the Tax Rebate for low income aged persons of $250 a year (for single people) and $175 a year (for each of a couple), with effect from 1 July 2000. The higher rebates will ensure that an extra 70,000 pensioners and self-funded retirees are not required to pay tax, and will provide an extra tax cut to 330,000 older people.

Refundable imputation credits

In addition, older Australians with low incomes will be major beneficiaries of the refundable imputation credits measure described in Chapter 3. An illustration of the benefits of this measure for them is shown below.

Refundable imputation credit

Lorraine is a single self-funded retiree with a taxable income of $12,000 a year. She has assets (other than her home) of $250,000, including $100,000 worth of shares (fully franked). The average dividend on her share portfolio is 4 per cent, providing dividend income of $4,000 a year and imputation credits worth $2,250. However, as Lorraine benefits from the low income aged persons rebate, she does not have to pay income tax and, consequently, she cannot make use of her imputation credits.

The introduction of refundable imputation credits means that Lorraine can now receive the full benefit of these credits, worth $43 a week. She also receives the full Aged Persons Savings Bonus and Self-Funded Retirees Supplementary Bonus, which provide the equivalent of an income stream of $250 a year. All together these measures are worth around $48 a week to Lorraine, increasing her income by more than 20 per cent.

Proposed New Structure for Family Assistance (projected July 2000 values)

Family Tax Benefit, Part A

Current System

Four forms of assistance

1. Family Allowance (FA)
2. Minimum Family Allowance (MFA)
3. Family Tax Payment, Part A (FTP(A))
4. Family Tax Assistance, Part A (FTA(A))

Four rates of assistance $/yr

1. Family Allowance: child aged 0-12 years — $2,615
2. Family Allowance: child aged 13-15 years — $3,402
3. Minimum Family Allowance — $637
4. FTP(A)/FTA(A) — $200

Family income test on FA

- Free area for one child — $24,350
- Taper — 50%

Family income test on Minimum Family Allowance and FTP(A)/FTA(A)

- Minimum Family Allowance cut-out (add $3,413 per child after the first) — $68,600
- FTP(A)/FTA(A): cut out (add $3,000 per child after the first) — $70,000
- Taper: — nil

New System

One form of assistance

1. Family Tax Benefit, Part A (FTB(A))

Three rates of assistance $/yr

1. Maximum benefit: child aged 0-12 years — $2,955
2. Maximum benefit: child aged 13-15 years — $3,742
3. Minimum benefit — $977

Total increases of $140 pa for each component

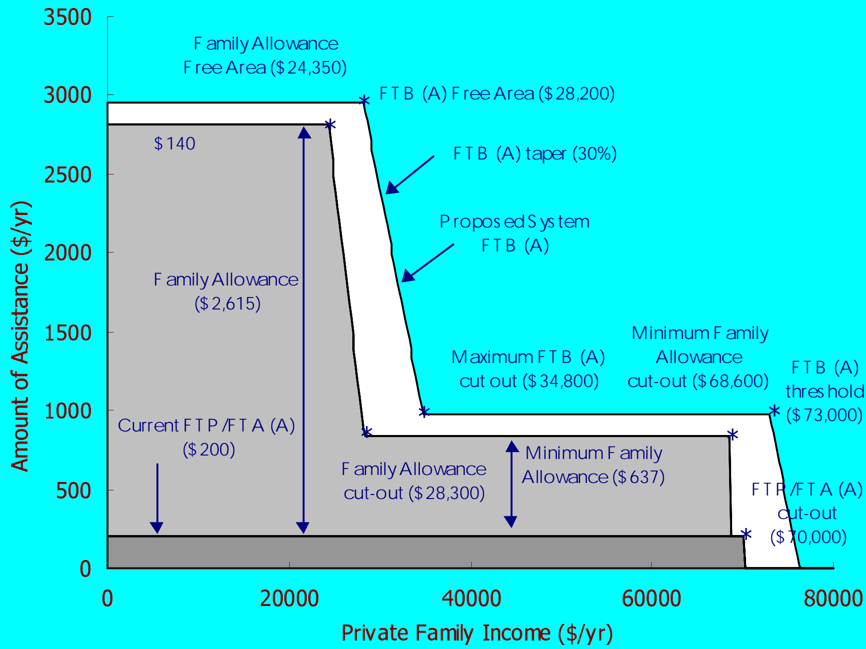
Family income test: maximum FTB(A)

- Free area: — $28,200
- Taper: — 30%

Family income test: minimum FTB(A)

- Threshold for one child: (add $3,000 per additional child after the first) — $73,000
- Taper: — 30%

Comparison of new and current systems (July 2000)
Family Tax Benefit, Part A (one child aged under 13 years)



Proposed New Structure for Family Assistance (projected July 2000 values)

Family Tax Benefit, Part B

Current System

Six forms of assistance

1. Dependent Spouse Rebate (DSR)
2. Basic Parenting Payment (BPP)
3. Family Tax Payment, Part B (FTP(B))
4. Family Tax Assistance, Part B (FTA(B))
5. Sole Parent Rebate (SPR)
6. Guardian Allowance (GA)

Ten rates of assistance

For single income couple families

Youngest child aged under 5 years	$/yr
1. DSR and FTP(B)/FTA(B)	$1,952
2. BPP and FTP(B)/FTA(B)	$2,290
Youngest child aged 5-16 years	
3. Dependent Spouse Rebate	$1,452
4. Basic Parenting Payment	$1,790

For sole parent families

Youngest child aged under 5 years	
5. GA and FTP(B)/FTA(B)	$1,496
6. SPR and FTP(B)/FTA(B)	$1,770
7. GA, SPR and FTP(B))/FTA(B)	$2,766
Youngest child aged 5-16 years	
8. Guardian Allowance	$996
9. Sole Parent Rebate	$1,270
10. GA and SPR	$2,266

New System

One form of assistance

1. Family Tax Benefit, Part B (FTB(B))

Two rates of assistance

	$/yr
1. Child aged under 5 years	$2,640
2. Child aged 5-16 years	$1,851

Total increases of $350 pa (child aged under 5) and $61 pa (child aged 5-16)

continued . . .

. . . continued

Proposed New Structure for Family Assistance (projected July 2000 values)

Family Tax Benefit, Part B

Current System

Income Test on DSR

	$/yr
♦ primary earner:	no test
♦ spouse	
- free area:	$282
- taper:	25%

Income Test on BPP

♦ primary earner:	no test
♦ spouse	
- free area:	$1,560
- tapers:	50/70%

Income Test on FTP(B)/FTA(B)

♦ primary earner: (add $3,000 per additional child after the first)	$65,000
♦ spouse	
- cut out:	$4,777
- taper:	nil

Income Test on Guardian Allowance (available to sole parent)

♦ same as for FA	
- free area:	$24,350
- taper:	50%

Income Test on Sole Parent Rebate (available to sole parent)

- no test

New System

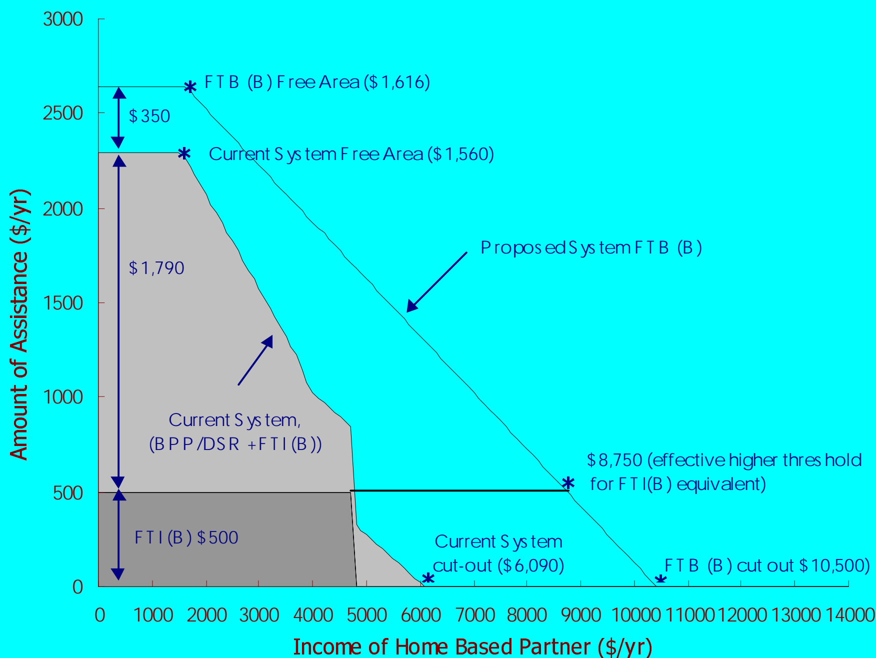
Income Test on FTB(B)

	$/yr
♦ primary earner:	no test
♦ spouse (couple families only)	
- free area:	$1,616
- taper:	30%
- cut out:	$10,500

Note: Under the spousal income test for FTB (B), entitlement to FTP (B)/ FTA (B) of $500 under the FTI is, in effect, extended from $4,777 a year of spousal income to $8,750 a year. Also, instead of the *sudden death* income test under the FTI at $4,777, entitlement to the FTB (B) tapers away at 30 cents in the dollar from $8,750.

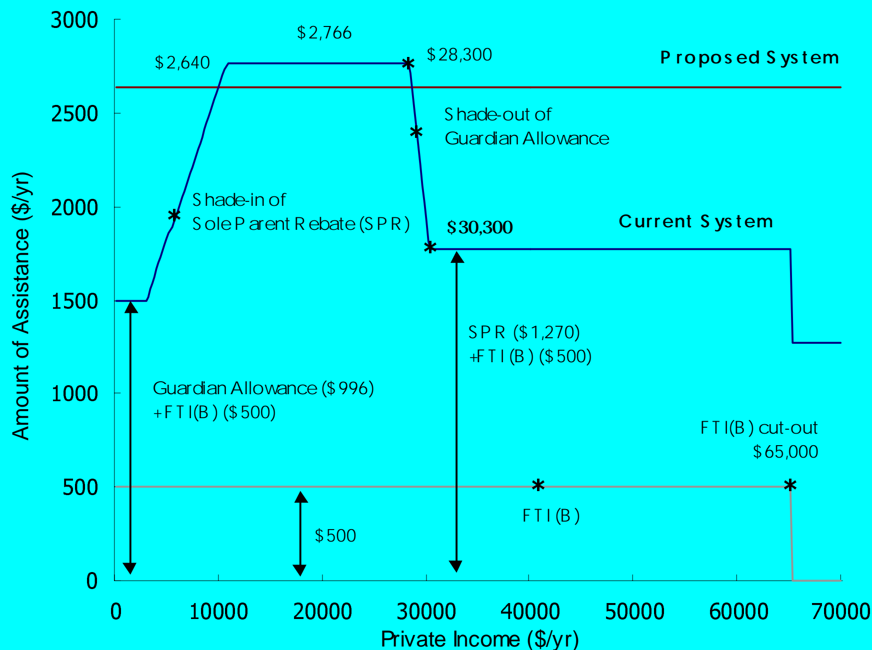
Comparison of New and Current Systems (July 2000)

Family Tax Benefit, Part B (single income couple family, one child under 5 years)



Comparison of New and Current Systems (July 2000)

Family Tax Benefit, Part B (Sole Parent with one child aged under 5)



Proposed New Structure for Family Assistance (projected July 2000 values)

Child Care Benefit

Current System

Two forms of assistance

1. Child Care Assistance (CA)
2. Child Care Cash Rebate (CCR)

Two rates of assistance

(maximum rates of assistance for one child and 50 hours of formal, work-related care)

	$/yr
♦ Child Care Assistance and ♦ Child Care Cash Rebate	$5,677

Family Income Tests

- CA (one child in care)
  - Threshold: $28,200
  - Taper rate: 12.25%
- CCR
  - No income test, but assistance reduces from 30 per cent to 20 per cent of net allowable fees when income exceeds $73,600 pa.

New System

One form of assistance

1. Child Care Benefit (CCB)

One rate of assistance

(maximum rates of assistance for one child and 50 hours of formal, work-related care)

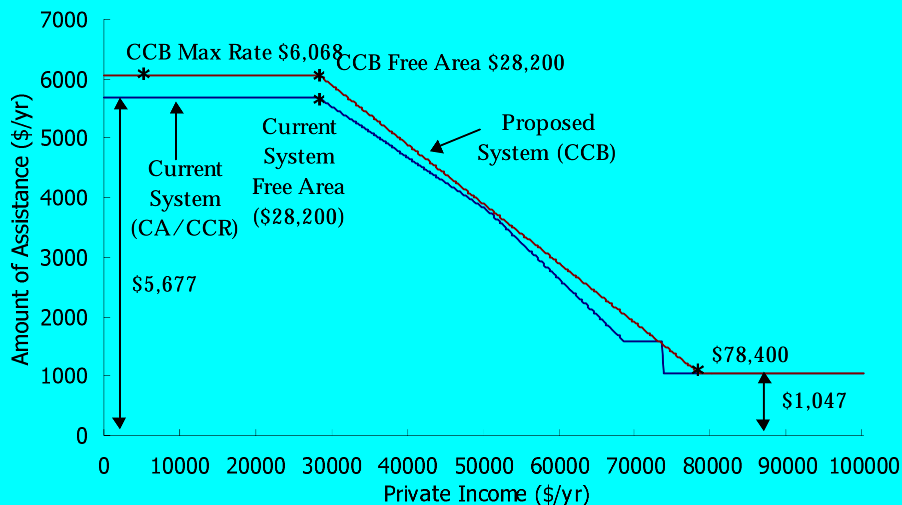
	$/yr
♦ CCB:	$6,068

Family Income Test

- Threshold: $28,200
- Taper rate: 10% (for one child in formal care)
- Income test ceases at $78,400

Comparison of New and Current Systems (July 2000)

Child Care Benefit: (1 child under 5 years, 50 hours of formal, work related care a week)



Revenue measures table: personal income tax and families*

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Personal income				
Personal income tax cuts	0.00	-13.06	-13.52	-14.49
Increase in pensioner and self-funded retiree rebates	0.00	-0.08	-0.08	-0.08
Abolish Savings Rebate	0.79	2.04	2.14	2.24
Tax rebate/benefit for private health insurance (a)	-1.02	-1.18	-1.27	-1.36
Income tax effect of other policy measures nei (b)	0.00	0.00	0.24	0.26
Total	-0.23	-12.27	-12.49	-13.43
Social security				
Aged Persons Savings Bonuses	0.00	-1.30	0.00	0.00
Increased assistance for social security recipients (c)	0.00	-1.79	-1.65	-1.72
Reduction in pension taper rate	0.00	-0.38	-0.40	-0.42
Total	0.00	-3.47	-2.05	-2.14
Family package (a)				
Rate increases	0.00	-1.11	-1.17	-1.23
Work incentives	0.00	-1.03	-1.08	-1.14
Simplification	0.00	-0.18	-0.19	-0.20
Total	0.00	-2.31	-2.44	-2.57
Fringe Benefits Tax				
Gross-up rate	0.00	0.25	0.26	0.27
Reporting fringe benefits on group certificates (a)	0.00	0.27	0.30	0.30
Capping concessions	0.00	0.24	0.25	0.26
Mining exemption (remote area housing)	0.00	-0.03	-0.02	-0.03
Total	0.00	0.73	0.79	0.81
Net budgetary impact	**-0.23**	**-17.32**	**-16.19**	**-17.33**

* A positive revenue or outlays number implies a positive impact on the budget balance.
(a) Includes both revenue and outlays components of the measure.
(b) Includes income tax effect of abolition of Financial Institutions Duty/debits tax, reduced pension taper rate and increased social security assistance.
(c) Includes 1 ½ per cent real increase.

Security
Reforms to indirect tax and State finances

Overview

Australia's indirect tax system has major problems. It is complex, unfair and penalises business. The States rely on indirect taxes that limit the development of our financial sector and are inequitable to taxpayers.

The Government will eliminate the wholesale sales tax and reform excise duties. This will cut business costs by more than 3 per cent and reduce exporters' costs by about $4½ billion a year. The Government will introduce a goods and services tax (GST) and give the revenue to the States. The States will have a secure and growing revenue source allowing them to abolish some of their worst taxes and remove their reliance on Federal grants.

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The problem

Wholesale sales tax is past its use-by date

Some excise duties produce undesirable outcomes

States suffer from an imbalance in taxing powers

State financial taxes are inequitable and put investors off

The goal

The strategy

The plan

Abolishing inefficient indirect taxes

Introducing a GST

Giving all GST revenue to the States

Ensuring fair prices

Reforming excise duties

Introducing a luxury car tax

The problem

Australians are subject to several inefficient indirect taxes. A key example is the wholesale sales tax. It was introduced in 1930 when the economy had a fundamentally different structure. It is now simply out of date. It taxes business inputs and penalises exports. It directly taxes a narrow range of goods, but not services which now make up over two thirds of Australia's economic activity. Successive governments have been forced to increase rates to maintain revenue, but this strategy is not sustainable. States[1] also have had to rely on taxes that unfairly burden the less affluent in our community and impede Australia's development as a major financial centre. We must reform our indirect tax system to ensure that it applies to a broad base of economic activity and has the flexibility to adapt to a modern economy.

Wholesale sales tax is past its use-by date

The wholesale sales tax is levied on a narrow base, has complex multiple classification rates and is difficult for business to comply with. More than half the money raised from it comes from taxing goods purchased by business and, in this way, it imposes a hidden tax on exports.

No other OECD country still has a tax of this type and there are only a handful of countries in the world that do — Botswana, Ghana, the Solomon Islands and Swaziland.

The wholesale sales tax base is too narrow

The wholesale sales tax has simply not kept pace with the development of the Australian economy. The main problem is that it does not directly tax services. This was not as important when it was introduced as services were a less significant part of the economy. Since then services have grown rapidly and are now more than two-thirds of economic activity. Revenue collected from the wholesale sales tax has been maintained, but only because past governments have increased the rates of tax. The 'general rate' has risen from 2.5 per cent to 22 per cent and the highest rate is now 45 per cent. This cannot go on forever. There is a limit to how high the rate can go. High rates increase incentives to avoid the tax. The current approach places an increasing burden on particular sectors, other tax bases, and administrative resources.

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1 The term 'States' is used to refer to both States and Territories.

Multiple wholesale sales tax rates lead to complexity and unfairness

Another flaw in the wholesale sales tax is that particular goods can be exempt, or taxed at one of six different rates. Multiple rates can lead to confusion and provide scope for tax avoidance. Consumers almost never know how much tax they pay on goods and may not even realise that they are bearing a hidden tax.

Multiple rates were first introduced in 1940 as a wartime measure to encourage resources to flow to war-related activities. Goods have been classed as luxuries according to the standards of the time. Many of these judgements are no longer relevant given changes in technology and social norms. Commonplace items like radios, watches, televisions and tape recorders are now taxed at the luxury rate of 32 per cent.

Wholesale sales tax applies at the wholesale level giving scope for avoidance

The wholesale sales tax is paid on the value of the *last wholesale sale*. This means that where goods pass through a distribution chain, from manufacturer to wholesaler to retailer to consumer, wholesale sales tax is paid when the wholesaler sells the goods to the retailer.

This approach may have made sense in 1930, when most goods passed through a simple distribution chain. It makes little sense today, when the line between wholesaling and retailing is often blurred. These days, the same company often conducts both activities. When there is no distinct wholesale sale, the wholesale price, and therefore the sales tax payable, must be 'estimated'. This is complex and gives rise to avoidance opportunities. Large businesses are often better placed to structure their arrangements to minimise their wholesale sales tax, giving them an advantage over small businesses.

Taxing business inputs and exports makes business less competitive

While the wholesale sales tax exempts many items for use in the manufacture of other goods (for example, raw materials), it does not provide an exemption for goods used in service activities, such as trucks used in road transport. As a result, the wholesale sales tax paid on goods bought by service industries is passed on to goods producers who buy those services.

More than half of wholesale sales tax revenue is raised on goods used as inputs to one type of business or another. For example, a manufacturing business will pay wholesale sales tax on the purchases of a computer that it uses to manage the accounts and the vehicles it uses for deliveries. That tax will raise its costs and, if the business exports its products, it will be less competitive internationally. The hidden tax burden also makes Australian business less competitive against imports.

Some excise duties produce undesirable outcomes

The excise duty on diesel fuel imposes a heavy cost on businesses, particularly those in rural areas that rely heavily on road transport.

The vastly different rates of excise duties on alcoholic beverages create competitive disadvantages. This means that spirits based drinks are at a competitive disadvantage compared to wine based pre-mixed drinks.

States suffer from an imbalance in taxing powers

States have the legal capacity to levy taxes. However, they are restricted by the Constitution in the types of taxes they can levy. They cannot levy taxes on goods, imports, exports or Commonwealth property. As a result, Commonwealth-State financial relations reflect a worsening imbalance in taxing powers, with the States relying on some indirect taxes that are highly inequitable, leading business and consumers to take distorted decisions for tax reasons.

State outlays outweigh revenue

The Commonwealth raises more revenue than is required to fund the programmes it delivers. In contrast, the States' expenditures outweigh the amount of revenue they raise themselves. This is often referred to as *vertical fiscal imbalance* or VFI.

Arrangements have had to be implemented to take account of this imbalance. Under the federal fiscal arrangements, the Commonwealth passes part of its revenue to the States. In 1998-99, the Commonwealth will provide around $32 billion of grants to the States (around 42 per cent of total State revenue).

Since Federation, a series of developments has restricted the taxation powers of the States. For example, in 1942, to help the war effort, the States passed their income tax powers to the Commonwealth. More recently, the High Court found that the Constitution does not allow States to levy business franchise fees (taxes on petrol, liquor and tobacco) or levy certain taxes on places acquired by the Commonwealth (for example, an office building). At the request of the States, the Government altered Commonwealth tax arrangements to raise, on behalf of the States, sufficient revenue to replace the revenue lost by the States from these decisions.

States rely on inefficient taxes

States currently raise almost one dollar in every four collected through taxation in Australia, through up to 35 different taxes in each jurisdiction. State taxes mainly fall on payrolls, land, financial

transactions, motor vehicles and gambling. Taxes on the sale of petroleum, tobacco and liquor are also a major State revenue source. However, as a result of the High Court decision the Commonwealth must levy these on behalf of the States.

Some State taxes, such as payroll and land tax, are applied or capable of being applied to a broad base. However, for the most part, the States depend on narrowly based taxes which are more likely to lead businesses and consumers to distort planning decisions for tax reasons and less likely to ensure equitable treatment of taxpayers.

State financial taxes are inequitable and put investors off

Several States have acknowledged in their recent budget papers the deficiencies of some of the taxes they levy. In particular, they have identified taxes on bank transactions and stamp duties as generating significant efficiency losses and performing poorly in equity terms.

Taxes on bank transactions are inequitable

Debits tax and Financial Institutions Duty (FID) are levied on a relatively narrow range of financial transactions. Variations in bases and the rates across States increase compliance costs and leads to uncertainty for taxpayers as to their tax liability.

The taxes on bank transactions unfairly burden the less affluent in our community. For example, those undertaking smaller transactions often pay relatively more tax than those who make large transactions because debits tax rates are specified as fixed dollar amounts per transaction. Further, large firms minimise their FID liability by bundling their transactions to take advantage of the cap on the maximum amount of FID payable per transaction. Individual consumers therefore bear a disproportionate tax burden.

Some consumers and business can also avoid FID by conducting their financial transactions in areas that do not impose a FID. For example, some Australians have bank accounts overseas or in Queensland where FID is not imposed. Taxpayers can also avoid paying debits tax by conducting their affairs through credit unions or by using accounts without cheque facilities.

Stamp duties limit financial development

The States levy a plethora of stamp duties on transactions and transfers — including on property conveyances, mortgages, leases, marketable securities, insurance, and hiring arrangements.

These duties are generally narrowly based, being levied on some but not other types of transactions, instruments or entities. Taxpayers have to

deal with different State tax bases and rates. This imposes significant compliance costs, particularly for those businesses that operate in more than one jurisdiction. These differences also create opportunities to avoid taxes, encouraging taxpayers and businesses to locate themselves, or conduct their activities, in States with lower stamp duties.

Stamp duties on marketable securities increase the cost of share trading in Australia. Many Australian companies are listed on stock exchanges in the US, New Zealand and Canada where there are no equivalent stamp duties. Foreign companies are also more inclined to list their shares in countries where such duties do not exist instead of trading on the Australian Stock Exchange. Combined with debits tax and FID, stamp duties on marketable securities adversely affect Australia's ability to develop as a financial centre in competition with others in our region and around the world.

A number of factors support the development of Australia as a major financial centre. It is not only in a time zone that would complement other major financial centres such as New York, London and, to a lesser extent, Tokyo, but it also has a stable government as well as a transparent, secure and efficient financial system. However our tax system impedes Australia's development as a major financial centre.

Abolishing these stamp duties will mean that the cost for households of hire purchase, rental agreements, cheques, mortgages and the cost of purchasing shares will fall.

State taxes on bank transactions and stamp duties

Taxes on bank transactions

Debits tax is levied on the value of withdrawals from bank accounts with cheque drawing facilities and is generally passed on to customers.

Financial Institutions Duty is levied on the value of receipts (credits) at financial institutions and is generally passed on to customers.

Key stamp duties on business

Conveyancing duty is levied on the transfer of business property (based on the sale price) and is usually paid by the purchaser.

Stamp duties may also be levied on credit arrangements, instalment purchase arrangements and rental (hiring) agreements. These include:

- hiring arrangements duty, which is levied on the rent paid in respect of the hire of goods;
- hire purchase arrangements duty, which is levied on the price of goods purchased under instalment purchase arrangements; and
- credit duty, which is calculated as a percentage of the amount loaned.

Lease duty is levied on the rental value of non-residential tenancy agreements.

Marketable securities duty is levied on the transfer of shares and other marketable securities of corporations and is usually levied on both the buyer and seller.

Mortgage and loan security duty is levied on the value of a secured loan.

Some State also impose stamp duty on cheques, bills of exchange, and promissory notes.

What's wrong with these State taxes?

The following excerpts from State budget papers identify State taxes which State governments consider are the least desirable on efficiency and equity grounds:

"The overall tax system includes taxes imposed by States, many of which are narrowly based, relatively inefficient and inequitable. These are the financial taxes such as financial institutions duty, debits tax, share transfer duty, loan security duty and stamp duty on business transactions."
(New South Wales, 1998-99 Budget Paper No.2, p. 5-18.)

"It is now widely recognised that a number of State taxes — particularly those imposed on financial and capital transactions — are narrowly based, inequitable and significantly impede Australia's international competitiveness"
(Victoria, 1998-99 Budget Paper No.2, p. 91)

"Aside from wholesale sales tax [wholesale sales tax], many of the more inefficient and inequitable taxes levied on Australia are those imposed by the States. These include financial institutions duty, debits tax and various stamp duties." (South Australia, 1998-99 Budget Paper No.2, p. 6-10.)

"Many of Australia's most inefficient taxes are levied by the States and it will be difficult to achieve meaningful tax reform without involving the States. Taxes on financial and capital transactions, particularly FID and debits tax, are generally considered the least desirable of State taxes."
(Western Australia, 1998-99 Budget Paper No.3, p. 176.)

The goal

We need a system that taxes a broad range of goods and services at a single low rate, rather than the present system, which taxes a narrow range of goods at numerous high rates. We need a system that will be fairer, less complex and provide a more reliable source of revenue.

Business and the community will benefit from the reform of our indirect taxes. Taxes on business inputs will be reduced. Exporters will be able to compete on equal terms with the rest of the world. It will be easier for the community to know how much tax they pay.

We need reform that provides the States with a stable source of revenue, allowing them to abolish bank transaction taxes and a number of stamp duties. This will reduce the cost of financial transactions, increase Australia's attractiveness as a major financial centre and give Australia a world class tax system.

The strategy

The Commonwealth is proposing a comprehensive, national approach to the reform of the indirect tax system. The strategy, which rests on the introduction of a broad based GST to replace wholesale sales tax, is to modernise our indirect tax system and remove the reliance of the States on Commonwealth grants and distorting taxes.

Earlier attempts at tax reform in Australia have had a substantial ‘tax mix switch’ motive — increasing indirect taxes substantially in order to fund large cuts in personal income tax rates (particularly the higher marginal rates). That is not the objective of this reform. A fundamental objective of this package is to halt the erosion of indirect tax revenue.

The impact on indirect tax collections of the 1993-94 Budget measures was 0.6 per cent of Gross Domestic Product (GDP). In describing those measures, the then Treasurer said in his Budget Speech that ‘(t)hey will halt the erosion of Commonwealth indirect tax revenue — thus preventing Australia's tax system becoming lopsided…Failure to act on the indirect tax side would create pressures for more weight on income tax, a weight which would fall most heavily on middle-income earners’.

The full year revenue impact of all of the indirect tax reforms in this package is around 0.7 per cent of GDP.

The 1993-94 Budget measures increased indirect taxes as a proportion of GDP temporarily. However, the continued reliance on the existing narrow indirect tax base meant that they were never likely to succeed

more than temporarily. The revenue erosion is once more evident, with the indirect tax to GDP ratio presently about one-and-a-half percentage points lower than its level of a decade ago. This tax reform package makes up less than half of that lost ground. But it does so in a way that differs markedly from the 1993-94 Budget strategy. The GST will ensure that the erosion of indirect tax revenue is halted permanently.

The package reduces the reliance of State governments on Commonwealth funds by about $20 billion a year. It also provides the States with a more robust source of revenue. By 2003-04 they are projected to be $370 million better off than under existing arrangements. Reflecting the strength of GST collections relative to the existing system of Commonwealth grants and narrowly based State indirect taxes, the Budgets of the States are projected to improve by $1.25 billion in 2004-05, $2.25 billion in 2005-06, and commensurately larger amounts in subsequent years. The enhanced revenue security of the States will ensure that they can provide a sustainable level of high quality services — such as hospitals, schools, roads and law enforcement — into the future.

Implementing these changes will require the active involvement and support of State governments. The Commonwealth is therefore proposing to hold a Special Premiers' Conference (after the next Federal election) to discuss the proposal for reform of Commonwealth-State financial relations.

The plan

Abolishing inefficient indirect taxes

The Government's tax reform plan abolishes ten types of indirect tax — one Commonwealth and nine State.

Abolishing the wholesale sales tax

As mentioned earlier, the wholesale sales tax was introduced in 1930 when the economy had a fundamentally different structure. It is now out of date, failing to tax the growing service sector. The Commonwealth will abolish the wholesale sales tax.

Abolishing inefficient State taxes

The GST revenue will enable the States to abolish a range of inefficient taxes.

The Commonwealth supports abolition of the following taxes and is including funding for their elimination as part of the reform package:

- Financial Institutions Duty;
- debits tax;
- stamp duty on marketable securities;
- conveyancing duties on business property;
- stamp duties on credit arrangements, instalment purchase arrangements and rental (hiring) agreements;
- stamp duties on leases;
- stamp duties on mortgages, bonds, debentures and other loan securities;
- stamp duties on cheques, bills of exchange and promissory notes; and
- ‘bed taxes’.

As noted above, these are ‘ad hoc’ taxes largely introduced where States have sought to tax consumption of services. Giving the GST to the States will eliminate the need for such taxes.

In order to ensure that the overall tax burden does not increase, access to GST revenue will be conditional on a commitment by the States not to reintroduce any of these or similar taxes.

It is estimated that, by itself, the elimination of the State bank transaction taxes, stamp duties on marketable securities and other duties mentioned above would result in a 0.9 per cent reduction in the Consumer Price Index (CPI).

Introducing a GST

A key element of the Government's indirect tax reform strategy is to introduce a broad based indirect tax to replace the wholesale sales tax and a number of State taxes. In line with the terminology in use in New Zealand and Canada, the tax will be known as a goods and services tax or GST. The GST has the advantages of:

- applying to a broad base;
- applying only one rate to taxable goods and services;
- being paid on the final selling price; and
- not taxing business inputs.

While some goods and services will be excluded from the tax (such as most health, education and childcare services — see below for an explanation of why these goods and services are being excluded), most goods and services will be included in the base.

Food and clothing will be subject to GST and this will contribute to the simplicity of the system. There will be no need to develop complex rules to differentiate basic food from takeaways or restaurant meals. Excluding food and clothing from GST would deliver much larger dollar benefits to high income earners than low income earners.

Embedding the value-added concept

The new GST will be based on the ‘value added tax’ model adopted by nearly all OECD countries and more than 80 other countries around the world. It will be a tax of 10 per cent on the consumption of most goods and services in Australia, including those that are imported, but it will not apply to exports of goods, or services consumed outside Australia.

The GST is a multi-stage tax.

Registered businesses will charge GST when they sell (supply) goods or services to another business or a consumer. When calculating the amount to pay to the Tax Office, businesses will offset the tax paid on their inputs (such as purchases of raw materials and machinery). This offset is referred to as an *input tax credit*. In this way, tax will be collected only on the value added by each business in the production and distribution chain, with the tax being ultimately paid by the final consumer. However, sales by one business to another will be effectively tax free.

If the tax collected on sales exceeds total ***input tax credits***, then the net difference will be paid to the Tax Office. If ***input tax credits*** exceed the tax collected on sales, a refund can be claimed. For example, if a business buys a major item of capital equipment, so that the tax collected in a given period is less than the tax paid on the capital item and other inputs, that business may claim a refund.

Facilitating implementation

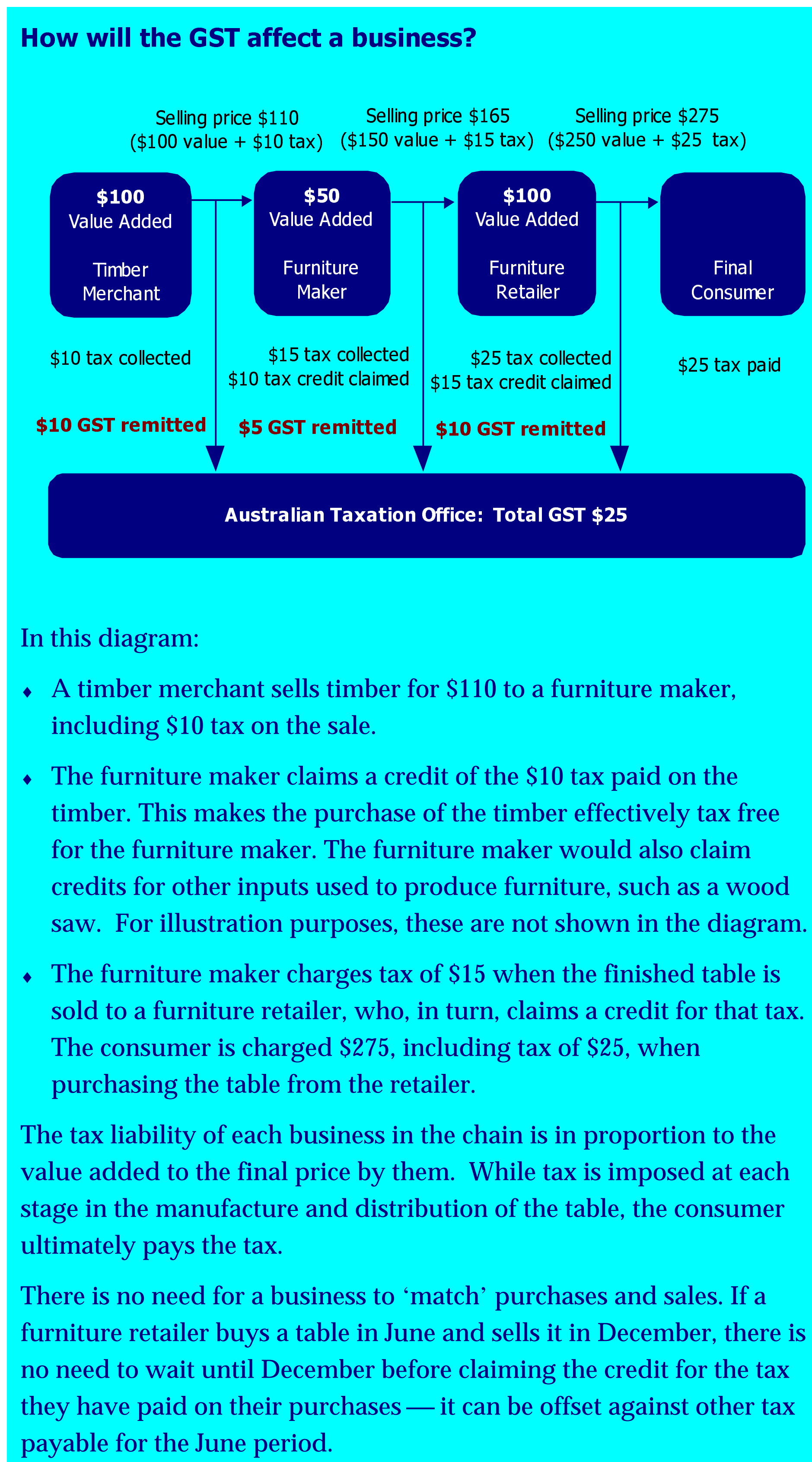
The GST will start on 1 July 2000. This will allow time for business taxpayers to learn about the new tax and establish appropriate administrative systems.

The Government will provide financial incentives of up to $500 million for small and medium businesses to upgrade their record keeping capacity through software and hardware, so that the start-up costs of a GST are minimised. Business will be consulted through a Small Business Consultative Committee to ensure that the financial incentives are targeted and delivered in the most effective way.

Before the start-up date, the Tax Office will undertake an extensive public information programme to ensure that businesses and consumers have all the information they need about the GST.

The Government will appoint a distinguished Australian to chair a Tax Consultative Committee comprising selected community representatives to assist the Government in targeted consultation on outstanding GST design issues and advise on the best methods of informing industry about the GST.

How will the GST affect a business?



In this diagram:

- A timber merchant sells timber for $110 to a furniture maker, including $10 tax on the sale.
- The furniture maker claims a credit of the $10 tax paid on the timber. This makes the purchase of the timber effectively tax free for the furniture maker. The furniture maker would also claim credits for other inputs used to produce furniture, such as a wood saw. For illustration purposes, these are not shown in the diagram.
- The furniture maker charges tax of $15 when the finished table is sold to a furniture retailer, who, in turn, claims a credit for that tax. The consumer is charged $275, including tax of $25, when purchasing the table from the retailer.

The tax liability of each business in the chain is in proportion to the value added to the final price by them. While tax is imposed at each stage in the manufacture and distribution of the table, the consumer ultimately pays the tax.

There is no need for a business to 'match' purchases and sales. If a furniture retailer buys a table in June and sells it in December, there is no need to wait until December before claiming the credit for the tax they have paid on their purchases — it can be offset against other tax payable for the June period.

Cash flow benefits for business

The payment arrangements for the GST will deliver a cash flow benefit to business. Most businesses will have the use of GST revenue they

collect for 21 days following the end of the quarter in which the tax is collected—this is an average of 66 days.

Reduced costs for business

Implementation of the package of indirect tax reforms will reduce business costs by more than 3 per cent. The cost of private investment goods should fall by about 7 per cent. Costs facing Australia's exporters should fall by about 3½ per cent, or about $4.5 billion a year. More detail on these benefits is provided in Chapter 5.

Giving all GST revenue to the States

Establishing a timetable for the removal of other taxes

The Commonwealth offer involves the States receiving GST revenue as of 1 July 2000. The temporary arrangements for fees on petrol, liquor and tobacco and Financial Assistance Grants (FAGs) will cease at that time. The States will continue to have the capacity to meet rebate arrangements introduced following the 1997 High Court decision on business franchise fees. For example, Queensland will be able to maintain its 8 cent per litre rebate on petrol.

The offer is conditional on the States eliminating some of their worst taxes and not reintroducing them in the future. On 1 January 2001, States would abolish FID and debits tax. They would also have sufficient revenue to abolish, from 1 July 2001, their stamp duties on marketable securities and other business transactions. The package assumes that their ‘bed taxes’ are abolished from 1 July 2000.

The States will be required to compensate the Commonwealth for the costs of administering the GST. The first payment will be required in 2000-01. This will cover administration costs in 1999-00 and 2000-01, projected to total $700 million. The States will not be required to contribute to the costs of systems development undertaken prior to 1 July 1999.

The package will ensure that the States are not worse off than if they were to continue receiving FAGs.

Devising a formula for equitable allocation of GST revenue

The Commonwealth will ensure that in each of the first three years following the introduction of the GST the States are no worse off financially than they would be under current arrangements. On the revenue projections contained in the package this will require the Commonwealth to make grants to the States in 2001–02 and 2002–03. In addition, the Commonwealth will make available to the States in

2000-01 a short term interest free loan, repayable the next year, to cover the financing shortfall in that year. From the 2003-04 year the States should be better off financially, and increasingly so, because the GST revenue will grow at a rate appreciably stronger than the Commonwealth payments and State taxes being replaced.

GST revenue will be distributed conditional on the States' applying horizontal fiscal equalisation (HFE) principles.[2] The Commonwealth Grants Commission will continue to determine the equalisation formula. States have expressed their support for HFE principles ensuring that all Australians can have access to similar standards of government services, regardless of where they live.

The Commonwealth Grants Commission, the organisation currently responsible for recommending an allocation formula for FAGs, will be asked to propose an equitable allocation of GST revenue. The new allocation will have to reflect the capacities and needs of each State as it currently does, as well as the fact that not all States currently levy the whole range of taxes to be eliminated.

Transferring responsibility for local government funding

Funding for local government has traditionally come from both Commonwealth and State governments. The national indirect tax reform means that the Commonwealth will no longer need to provide general purpose assistance to local government. States would have sufficient funds to ensure adequate funding arrangements for local governments.

The Commonwealth would therefore require that States take responsibility for the payment of general purpose assistance. The Commonwealth will make the payment of the GST revenue conditional on the States making these payments in accordance with existing conditions on the payment of general purpose assistance to local government, including the road funding component. Maintaining the growth in general purpose assistance to local government on a real per capita basis would constitute one of the conditions to be met by the States in order for them to receive GST revenue. These payments will ensure that local government is no worse off on this front. In addition, the reduction in the costs of government resulting from the replacement of the wholesale sales tax with a GST, and the fact that local government rates will be *GST-free*, means that local government will benefit from tax reform. They will be able to recover the GST they pay on their inputs.

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2 General revenue assistance provided by the Commonwealth to the States is partly distributed taking into consideration the differences in the capacities of the States to raise revenues and in the amounts required to be spent to provide an average standard of government services. The complex methodology that recognises these differences is called *horizontal fiscal equalisation*.

Local government is expected to benefit by around $70 million each year by not paying wholesale sales tax embedded in the products it buys.

Locking in the GST rate

The Government has taken careful note of concerns expressed that a future Commonwealth government could increase the GST rate. These concerns relate to overseas governments which have increased value-added tax (VAT) rates after introduction. Principally this has been done to increase government spending.

As GST revenue will be directed to the States, the Commonwealth Government would not only have to agree to introduce legislation to increase the GST rate, but the request for such a change would have to be unanimous among State Premiers and Territory Chief Ministers. Legislation would then need to be passed by both Houses of the Federal Parliament.

Ensuring fair prices

The removal or reduction in a number of taxes will moderate the price impact of the GST. For example, the average impact of the wholesale sales tax on consumer prices (as measured by the CPI) is over 4 per cent. This burden is generally hidden from the public by the nature of the wholesale sales tax. Other taxes being abolished or reduced should also act to reduce prices.

In general, it can be expected that the competitive pressures that already exist within the economy will ensure that a fall in the tax rate on a product will flow through to consumers in the form of lower retail prices.

However, the Government recognises that with the transition to a new tax system, there will be legitimate community concern regarding the possibility of consumer exploitation and excessive profit taking.
In measures designed to counter excessive profiteering, the Government will legislate to provide the Australian Competition and Consumer Commission (ACCC) with special transitional powers to formally monitor retail prices. The transitional price oversight regime will begin 12 months prior to the implementation of the GST and will continue for a further 2 years after the date of introduction.

The ACCC will be required to monitor retail prices in order to identify instances where consumers have not fully benefited from reductions in the tax rate, or have been exposed to greater than necessary prices rises.

The Commonwealth will consult with the States with a view to ensuring the ACCC has statutory authority to take action under its Act against unfair business practices that adjust prices in a manner that is not consistent with changes in tax rates. Breaches of the Act carry penalties

of up to $10 million. The ACCC will report to the Government on a regular basis. Those reports will be made publicly available.

Reforming excise duties

Reducing excises on petroleum fuels

The Government's reforms will significantly reduce the cost of fuel to all businesses, but particularly heavy transport, marine transport, and rail.

At the time of the introduction of the GST, the government will reduce excises on petrol and diesel so that the pump price of these commodities for consumers need not rise. This approach recognises that, although petroleum fuels are exempt from wholesale sales tax, they currently bear significant tax in the form of excises and the GST ought not to be used to increase that burden.

Under the GST, registered businesses will pay less for petrol and diesel because they will be able to claim an *input tax credit* for the GST payable on fuel used for business purposes. Businesses will save about 7 cents per litre relative to what they pay now.

As an additional boost to transport (especially rural transport), the Government will introduce a new comprehensive diesel fuel credit for *registered* business. The credit will be delivered through the GST system. This credit will reduce the effective excise payable on diesel fuel used in heavy transport (vehicles with a gross vehicle mass over 3.5 tonnes) and rail from around 43 cents per litre to 18 cents per litre. All other off-road business use of diesel and like fuels (including diesel, bunker fuel and light fuel oil for marine business use) will qualify for a full credit of excise. This represents a broader exemption than the current Diesel Fuel Rebate Scheme and, as a consequence, that Scheme will no longer be needed by business. Alternative fuels will remain excise free on the introduction of the GST.

The benefit of these measures is around $3½ billion a year. It is estimated that, together with other measures in the package, they will reduce road transport costs by 6.7 per cent, rail transport by nearly 4 per cent and water transport by 5.7 per cent. These cost reductions are industry averages. For rural and regional Australia, which relies most heavily on heavy road transport and rail, the cost reductions will be even larger.

The Government's transport reform package underscores its commitment to rural Australia.

Separate rebate arrangements will continue to provide relief from excise for certain private, off-road use of diesel, such as remote power generation (including generators not currently eligible). The Government will take the opportunity to improve the non-business coverage of the former scheme.

The taxation of alcoholic beverages

The existing taxation treatment of alcoholic beverages reflects factors that range from government health and industry assistance policies, to the impact of historical circumstances (such as the 1997 High Court decision that certain State business franchise fees were prohibited by the Commonwealth Constitution).

The Government has decided that, from 1 July 2000:

- Wine, and beverages consisting primarily of wine, will become subject to a Wine Equalisation Tax to replace the difference between the current 41 per cent wholesale sales tax and the proposed GST. The Wine Equalisation Tax will be levied at such a rate that the price of a four-litre cask of wine need only increase by the estimated general price increase associated with indirect tax reform; ie 1.9 per cent. The concessional taxation treatment of the alcohol content of cask wine will therefore be preserved.
- The excise on beer, and other beverages with less than 10 per cent alcohol content, will be increased to make up for the removal of the present 37 per cent wholesale sale tax. An excise will be imposed on drinks such as alcoholic cider. However, the change in excise will be limited so that the retail price of a carton of full strength beer need only increase by the estimated general price increase associated with indirect tax reform.
- To continue support for the production of low alcohol beer, the Government will increase the excise-free threshold for beer, from the present level of 1.15 per cent, to 1.4 per cent. This will mean that the retail price of a carton of low alcohol beer should not increase and, in some cases, may fall slightly. This will increase the price differential between full strength and low alcohol beer.
- The excise on beverages other than wine, with more than 10 per cent alcohol content, such as spirits and liqueurs, will rise to offset the removal of the wholesale sales tax. The change in excise will be limited such that the retail price of whisky, which is currently heavily taxed, will not need to change. The brandy excise rate will increase but remain below the rate applying to other spirits.

The net effect of these changes will be that cask wine remains concessionally taxed, without allowing the taxation changes to further increase its price advantage compared with beer. However, the tax incentives to use wine based alcohol in mixer drinks will be substantially reduced.

Table 2.1:
Changes to alcoholic tax and prices

	Total tax		Price	
	Current	Proposed	Current	Proposed
Beer (carton)				
regular	$11.92	$12.85	$26.93	$27.43
low alcohol	$5.45	$5.84	$22.00	$21.96
Wine				
4 litre cask	$2.65	$3.05	$10.94	$11.15
medium priced bottle	$3.07	$3.75	$14.89	$15.35
expensively priced bottle	$5.65	$6.63	$24.76	$25.35
Other				
Whisky (700ml)	$17.73	$17.95	$28.94	$28.92
Brandy (700ml)	$12.82	$14.44	$19.96	$21.46

Note: The price changes incorporate both the direct and indirect impact of tax changes, including reductions in industry costs.

Improving tobacco excise arrangements

The Government will take the opportunity to improve the current arrangements for taxing tobacco. At present, tobacco excise is calculated under a complex formula involving a combination of a Commonwealth weight based charge, plus a hybrid State surcharge based on both the wholesale price of tobacco and the weight. These complex arrangements were introduced as a short term measure to shore up State revenue when their business franchise fees on tobacco products were held to be unconstitutional by the High Court.

Very few other countries in the world still collect tobacco excise based on weight, because such an arrangement encourages people to smoke more, lighter cigarettes. This creates greater health problems than smoking even the same amount of tobacco in fewer cigarettes.

The Government has therefore decided to adopt the form of tobacco excise recommended by health experts and favoured by most other countries, which is based on the number of cigarettes produced, not the overall weight of tobacco in them. This form of excise is known as a *per stick* excise and will apply from 1 July 1999. Cigars and other tobacco products will continue to be subject to excise according to their tobacco weight.

Health experts have also recommended that tobacco taxes should be increased by 15 per cent at the same time as moving to a per stick excise. The Government has decided not to do this, but has determined that the

measure will be introduced in such a way that no cigarette brand will fall in price.

After the introduction of per stick excise and the application of GST, premium branded 25s will be expected to rise by approximately 6½ per cent. The per stick excise will remove the current tax advantage of light cigarettes (especially those in high volume packets such as 50s). These will increase substantially more — an intentional outcome of the design of this excise on the basis of health grounds.

Introducing a luxury car tax

Cars in general will fall in price as a result of the change from the wholesale sales tax to the GST. If the Government took no specific action, then the price of luxury cars would fall dramatically as they are currently subject to the special wholesale sales tax rate of 45 per cent. The Government does not believe that this price reduction is appropriate following the replacement of the wholesale sales tax with the GST. Therefore, the Government will introduce a retail tax on luxury cars, at a rate of 25 per cent of the value above a luxury threshold (a GST-inclusive value of $60,000). The tax will ensure that luxury cars only fall in price by about the same amount as a car just below the luxury threshold. Businesses subject to GST will not be able to obtain an *input tax credit* for the tax on luxury motor vehicles.

Key features of the GST

The GST will be similar to value added taxes operating in other countries. Definitions and administrative requirements will, where practicable, be harmonised with income tax to reduce compliance costs.

The GST will apply to supplies made by registered persons engaged in taxable activity. Private sales by unregistered people (for example, items in a garage sale) will not be taxed.

Registration

Individuals, partnerships, companies, trusts and other bodies that engage in taxable activity will be required to register if their total sales will exceed $50,000 per annum. Non-profit societies, clubs and associations will only need to register if their total sales (including membership fees, but not donations) will exceed $100,000 per annum.

Although individuals, businesses and clubs with smaller annual sales will not have to register, they will have the option of registering if they wish. If they do not register, they will not charge tax on their sales (outputs) or claim back tax paid on their purchases (inputs).

Registered persons will pay tax or claim refunds either quarterly (on 21 October, 21 January, 21 April and 21 July) or monthly, depending on their sales volume. Those with total value of sales less than $20,000,000 per annum may operate under a quarterly taxable period (but may opt for a monthly period), while larger businesses must remit on a monthly basis. All remitters, but particularly quarterly remitters, will get significant cash flow benefits from holding the tax before forwarding it to the Tax Office.

Displayed prices will include any GST payable.

Large businesses will account for the GST on an accruals basis, usually when an invoice is issued, consistent with the way they report their sales for income tax purposes. This means that one set of accounts will satisfy their income tax and GST reporting obligations. Registered persons with total sales less than $250,000 per annum will have the option of accounting for the GST on a payments basis (that is, when payments for sales are received).

Large businesses (who must remit monthly) will lodge their GST returns and make payments electronically. The Tax Office will pay all refunds directly to bank accounts and interest will be payable where refunds are not paid within 14 days.

The Government will spend up to $500 million to defray start-up costs of small and medium businesses implementing the GST. The Government will consult with business through a Small Business Consultative Committee on the most effective options for delivery of these incentives.

On-going administration costs of a GST will be less significant for businesses with good record keeping practices. In fact, overseas experience suggests that compliance costs will fall as familiarity with the rules and methods of a GST increase. Overseas experience also suggests that in order to comply with GST obligations businesses often improve their accounting systems, enhancing the quality of information upon which business decisions are made.

Taxable activity

A *taxable activity* is any supply of goods or services for a payment, whether in cash or kind. However, certain supplies will be excluded from the definition of taxable activity. For example, wages received by

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Key features of the GST

employees will not be taxable under the GST – in practice employees will not be caught up in the GST system. Private activities and some other supplies that will be *input taxed* (see below) will also not be taxable activities.

In line with the treatment of new goods, sales of used goods will generally be taxable if sold by a business, but not if sold by a private individual. This means that a family will not charge the GST when selling its house, used car, boat, or caravan, or when holding a garage sale. Where used goods are sold by dealers, the GST will in effect apply only to their *value added* (that is, their margin).

The GST base — very few exceptions

The GST will apply to a very broad base, but some supplies of goods and services will not be taxable.

Goods and services will not be taxable where imposing GST would be technically difficult or would create inequities between private and public sector providers.

Where goods are given away (for example tasting samples in a winery) no sale has occurred and there will be no GST paid.

There will be two types of non-taxable activities under the GST:

- activities that are not taxed and where credit is allowed for tax paid on purchases (known as *GST-free*); and
- activities that are not taxed and no credit is allowed for tax paid on purchases (known as *input taxed*).

Activities that are *GST-free*

Where activities are *GST-free*, a *registered person* will not charge tax on the sale of those goods and services, but will nevertheless claim back the tax paid on inputs. Other countries use the term *zero rated* to describe this type of activity.

Activities that are input taxed

Some activities will be *input taxed*. These activities will not be taxable, but anyone selling them will not be able to claim credits for the tax paid on their inputs.

This approach has been chosen where it is technically difficult to impose GST on the sale of particular services, but it is not appropriate to allow the sale to be *GST-free*. Other countries use the term *exempt* to describe *input taxed*.

Input tax credits

Registered persons will be able to claim credit for GST paid on purchases of business inputs (*input tax credits*). This will mean that purchases of business inputs will bear no GST, enhancing business competitiveness. *Input tax credits* can also be claimed by those providing *GST-free* activities, reducing the cost of undertaking these activities. *Input tax credits* will not be allowed for the GST paid by business on inputs used in activities that are *input taxed*. Where inputs are used in a mix of taxable and other activities, a partial *input tax credit* will generally apply, based on the proportion of taxable use.

Input tax credits will not be allowed for GST paid on goods and services for the personal use of sole proprietors and partners. Personal use tests will be similar to the current tests for non-deductibility under the income tax system. *Input tax credits* will not be allowed for the GST paid on certain inputs that are essentially private in nature (for example, meals and entertainment expenses).

Where goods or services are provided to employees as *fringe benefits*, the GST credit will be allowed, but Fringe Benefits Tax will be adjusted so that there will be no advantage for the employer in providing benefits rather than providing salary.

Activities that are *GST-free*

Exports

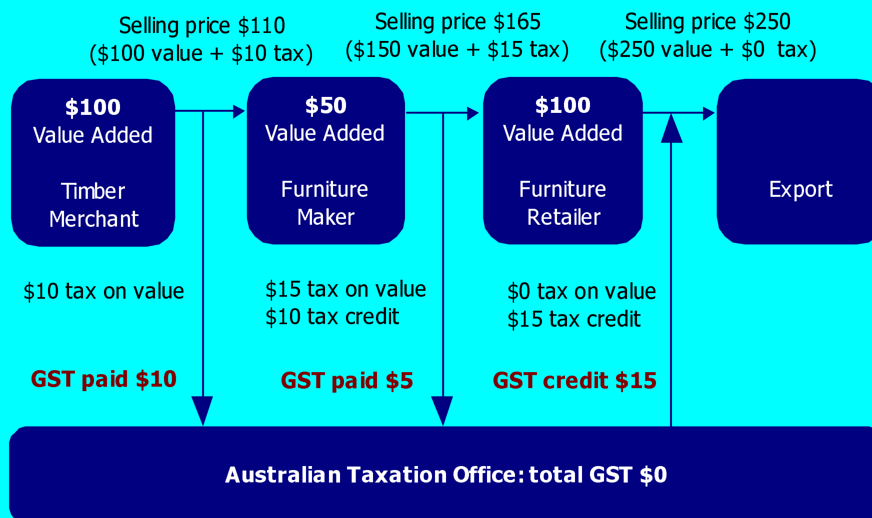
Exports of goods and services will be *GST-free*. This treatment, coupled with the removal of wholesale sales tax and the various State taxes, will reduce the costs to exporters by around $4½ billion in Australian dollar terms in the first year of operation of the GST. Exported goods must be physically exported from Australia and exported services must be performed outside Australia for a non-resident. An example of how no GST is paid on exported goods is presented below.

Tourists

Goods and services consumed by tourists in Australia, such as meals and hotel accommodation will be taxable in the normal manner. International air and sea travel will be *GST-free*, as will any domestic air travel purchased overseas by non-residents. Tourists and Australian residents going overseas will be able to recover the GST they pay on goods purchased in Australia and taken away with them when they leave. Refunds will apply to purchases of at least $300 made from any one business within 28 days of departure.

However, if the goods are subsequently brought back into Australia, then GST will be payable at that time.

Example of an export sale



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Activities that are *GST-free*

Health and medical care

The health sector in Australia has significant government involvement through direct subsidy and regulation. Many health services are provided to patients free of any direct charge or by means of a co-payment that is a fraction of the total cost of providing the service.

Applying taxes to health care would place the private health sector, with its heavier reliance on direct fees, at a competitive disadvantage with the public health system.

For this reason, most medical and hospital care services and health insurance will be *GST-free*. The cost of providing health care and insurance will fall as a result of the Government's indirect tax reforms as input taxes will be systematically removed from the sector.

Medical services

Medical services will be *GST-free* if they attract a Medicare benefit or are commonly used health services, listed by the Government. Examples of *GST-free* health services are:

Health services covered by Medicare:

- general practitioner and specialist consultations; and
- diagnostic, surgical and therapeutic procedures (for example, ophthalmology, neurology, optometry, radiation oncology, anaesthetics, radiology, ultrasound etc) and pathology.

Other medical services that will be *GST-free* include:

- hospital charges (accommodation etc);
- dental services;
- optical;
- physiotherapy, chiropractic;
- speech therapy;
- occupational therapy;
- counselling services;
- home nursing;
- dietary services; and
- podiatry.

The precise scope of qualifying medical services is a matter on which the Government will take a final decision following advice from the Tax Consultative Committee.

Hospitals and nursing homes

Health care provided at hospitals, nursing homes, hostels and similar establishments will be *GST-free*, as will nursing care services supplied to patients at home. The concession will extend to accommodation, drugs, dressings and meals supplied to patients or nursing home residents in the course of their treatment or care. Supplies of items not related to health care, such as food served in hospital cafeterias, or televisions rented to patients, will be taxable in the normal manner.

Medical appliances and aids

The supply of medical appliances for use by people with severe medical conditions or disabilities (examples include wheel chairs, crutches, artificial limbs and modifications to motor vehicles for the disabled) will be *GST-free*.

The precise scope of qualifying medical appliances is a matter on which the Government will take a final decision following advice from the Tax Consultative Committee.

Drugs and medicines

Drugs and medicines that can only be provided on prescription and PBS and RPBS medicines provided on prescription will be *GST-free*. The Government will take a final decision on the precise scope of qualifying drugs and medicines following advice from the Tax Consultative Committee.

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Activities that are *GST-free*

Education

Like health and medical care, education receives significant government assistance. Public primary and secondary education is provided free of charge and significant assistance is given to private schools and tertiary and vocational education. Applying the GST to education would discriminate against private providers.

Most educational services will therefore be *GST-free*. This treatment will apply to:

- tuition at or through a pre-school, primary or secondary school;
- tuition provided at a college, TAFE, university or other recognised institution that leads to a degree, diploma, certificate or other similar qualification; and
- the provision of accommodation at boarding schools.

The precise range of recognised institutions and courses that qualify as *GST-free* will be finalised following advice from the Tax Consultative Committee.

Some related goods and services will be taxable

All mainstream education will be *GST-free*. However, additional activities that would normally be taxed will not become *GST-free* simply because a school acts as a purchasing agent. Goods (such as computers and books) and services sold or leased to students by any educational institution will be taxable in the normal way. However, goods loaned to students free of charge will not be taxed.

Activities that are not *GST-free* include:

- the food component of boarding fees, and food and beverages sold to students (eg in tuck-shops);
- school bus services and uniforms;
- fees charged for equipment hire (eg musical instruments); and
- sales of goods and services for fundraising purposes.

Courses that do not lead to a recognised degree, diploma, or certificate, such as business training (for example, team development, writing skills etc) will be taxable. However, most businesses will be able to claim *input tax credits* for tax on course charges.

Childcare

Because childcare often includes an educational component, childcare provided at a recognised facility will be *GST-free*. As a result, childcare provided at facilities that receive government funding, or where the parents qualify for a government childcare payment, will be *GST-free*. This will apply to such things as long day care, short care (before and after school), family day care, occasional care and childcare facilities at fitness clubs and registered clubs.

Other forms of childcare, such as that provided by baby sitters, play centres, holiday camps, sporting and craft programmes will be taxable. However, many of these providers will be below the small business threshold ($50,000 for businesses and $100,000 per year for a non-profit organisation) and will not be required to charge GST.

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Activities that are *GST-free*

Charitable activities

Charities, public benevolent institutions, community groups and religious organisations operate differently from businesses. They often do not charge for the goods and services they supply, or impose only a nominal charge. Much of their funding and inputs are provided as donations.

Their charitable activities will be *GST-free*. Non-commercial supplies of goods or services by them will also be *GST-free*.

To avoid unfair competition with business, the commercial activities of these bodies will be taxable. Memberships of registered organisations (for example, local sporting clubs) will be taxable, but donations (which are not payments in return for services) will not be taxable.

In practice many community organisations will be below the $100,000 registration threshold and their memberships will not be taxed.

Religious services

Religious services will be *GST-free*. Churches and other institutions that supply religious services will not charge tax on those services and will be able to claim *input tax credits* for tax paid on their inputs.

Religious items for use in private devotion will be taxable. The precise range of religious services that will qualify as *GST-free* will be finalised following a report from the Tax Consultative Committee.

Activities that will be input taxed

Financial services

Some financial services are structured in a way that makes it extremely difficult to subject them to GST. The international experience has been that it is difficult to identify and measure the value added of many financial services on a transaction by transaction basis. However, there is no reason why private consumption of financial services should be tax-free. In principle, all financial services should be taxed in the same way that other goods and services are treated.

The Government will *input tax* some financial services in line with current international practice.

For example, a bank will pay GST on a computer bought for use in managing credit card accounts. The bank will not be entitled to an *input tax credit* for tax paid on the computer. However, no tax will be payable on the credit card charges of the bank. The precise range of services that would be taxed or *input-taxed* would be determined in consultation with industry.

Exports of financial services will be *GST-free*, in line with the treatment of other exports.

Other financial services, such as investment advice, where there is a readily identifiable fee or charge, will be taxable.

Residential rents

Residential rents will be *input taxed* to ensure comparable treatment for renters with owner-occupiers.

How will the GST affect other sectors?

Housing

The construction and sale of new homes, and repairs and renovations to existing homes, will be subject to GST in the normal manner. Residential rents will be *input taxed.*

Residential land will be treated like second hand goods. That is, when it is sold by a registered business (such as a property developer), it is not subject to GST on its full sale price, but only on the margin added by the business. There is no tax when land is sold by private individuals, or on the sale of an existing family home.

The current tax system imposes a hidden tax burden on homes. Wholesale sales tax is currently paid on some materials used in constructing and finishing a house, such as carpets, bathroom fittings, heaters and air conditioners. Financial taxes impose a further burden on the price of a home. The Government's reforms will remove a hidden tax burden of approximately 5.3 per cent of the cost of constructing a new house.

If nothing else were done, a GST would raise the prices of new homes by about 4.7 per cent. Although existing home owners would benefit from a rise in the value of their homes, those who do not currently own a home would face higher purchase prices and possibly higher rents.

To maintain home affordability at its present high levels, the Government will require the States to assist home buyers through a First Home Owners' Scheme as a condition of receiving GST revenue.

People who qualify for assistance will receive a lump sum payment of $7,000 from July 2000. Payment will *not* be means tested. Because it is a flat amount, people purchasing more expensive first homes will receive proportionally less benefit than those buying less expensive homes. People who buy an older house will find that this payment assists them to fund renovations. A first home owner will be more than compensated on the purchase of a home with a construction value (excluding land) of up to $150,000.

Eligibility for the First Home Owners' Scheme

The First Home Owners' Scheme will apply to Australian citizens and permanent residents who are buying or building their first home in Australia. To qualify, an applicant or an applicant's spouse must not have previously owned a home, either jointly, separately, or with some other person.

The purchase of a *first home* will include the purchase of the land on which a house is to be built and cover all forms of private dwelling ownership (strata title etc).

Accommodation

Supplies of short term accommodation in hotels and similar establishments will be taxable. Long term stays (for twenty-eight days or more) will be *input taxed* in line with the general treatment of residential rents.

Other construction

The construction, sale and leasing of all non-residential land and buildings, whether new or used, will be subject to tax. This treatment will allow virtually all businesses to claim *input tax credits* for the tax payable on such buildings they occupy or own. This will make the purchase or lease of a building effectively ‘tax free’ for them.

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How will the GST affect other sectors?

Government

The Government's intention would be to apply the GST to the commercial activities of all levels of government in the normal manner. However, there are Constitutional limitations on subjecting some activities of government to the GST.

To overcome these limitations, the Commonwealth will be seeking the agreement of the States to ensure that a consistent national approach is taken to taxing commercial activities of all levels of government.

The non-commercial activities of government will be outside the scope of the GST. For example, appropriations for general government activities will not be taxable, nor will grants from one level of government to another, as neither constitutes consideration for a supply.

Fines, penalties, and taxes are not usually commercial transactions. The range of taxes and charges that will not be subject to the GST is extensive and will include taxes and charges levied at all levels of government. Examples are:

- income tax;
- Medicare levy;
- land tax;
- stamp duties;
- motor vehicle registration fees;
- water and sewerage rates and charges; and
- local government rates.

Like taxable businesses, governments will be entitled to claim *input tax credits* on all their purchases. This will lead to a fall in the running costs of general government.

Gambling and lotteries

Gambling and lottery activities will be included in the tax base. The GST will apply to the operator's margin of these activities, not to the prizes paid out. That is, the tax will apply to the difference between total ‘ticket sales’ or ‘bets taken’ by the operator of the gambling or lottery activity and the value of the prizes or winnings paid out. However, operators cannot always adjust their prices because these are often set by the rules of the game or by State government legislation relating to levels of pay-out. As the States already tax gambling highly there may need to be corresponding reductions in State gambling taxes. This will be possible because, under the proposed arrangements, the States will receive the proceeds of the GST, including the GST on gambling.

GST transitional arrangements

To ensure a smooth transition from the wholesale sales tax to the GST, certain transitional arrangements will apply.

Credit for wholesale sales tax on tax-paid stock

When the GST is introduced, many businesses will be holding inventories of new goods for sale on which wholesale sales tax will have been paid. To prevent double taxation, businesses may claim a credit of the wholesale sales tax paid on stock against their GST liability.

Harmonising wholesale sales tax rates

After the GST is introduced, many goods will fall in price. In particular, so called 'luxury' goods taxable at the 32 per cent wholesale sales tax rate (for example stereos and televisions), are likely to fall in price.

To avoid consumers holding off on purchases, the Government will reduce the 32 per cent wholesale sales tax rate (other than that applying to furs and jewellery) to the standard 22 per cent rate immediately following the passage of the GST legislation.

Phase in of *input tax credits* for motor vehicles

The introduction of the GST will significantly reduce the cost of business by providing *input tax credits.* This causes a transitional problem as businesses that currently bear wholesale sales tax may delay some of their purchases so that they can get *input tax credits.*

The Government is concerned that this may disrupt the motor vehicle market.

To alleviate this problem the Government will phase in *input tax credits* for motor vehicles over a two year period. In the first year of operation no input credits will be allowed for motor vehicle purchases. In the second year, half the value of the full *input tax credit* will be allowed. Full *input tax credits* will be available in the third year and the system will be fully operational.

Bodies that can currently purchase motor vehicles exempt from wholesale sales tax will not be affected by this measure. These bodies would have no incentive to delay purchases and so they will be able to claim full *input tax credits* from the date of implementation.

The Government will take a final decision on these matters following advice from the Tax Consultative Committee.

Contracts that span the implementation date

Some contracts and agreements will span the date of implementation of the GST. Where this occurs, the general principle will be that GST applies to all goods delivered and all services performed after the implementation date.

Revenue measures tables: indirect tax*

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
GST				
GST revenue (a) (b)	0.00	27.20	31.96	32.81
WST				
WST abolition (b) (c)	-0.56	-15.32	-17.75	-18.75
Other indirect taxes abolished/ reduced				
Reduced gambling taxes (b) (d)	0.00	-0.48	-0.56	-0.59
Abolition of FID/debits tax (b) (e)	0.00	-0.97	-2.39	-2.46
Abolition of business stamp duties (f)	0.00	0.00	-2.33	-2.41
Abolition of accommodation taxes (g)	0.00	-0.08	-0.06	-0.06
Abolition of business franchise fee replacement taxes	0.00	-6.65	-7.04	-7.24
Total	0.00	-8.19	-12.38	-12.76
Changes to excise				
Petrol (b) (h)	0.00	0.44	0.48	0.50
Diesel (b) (i)	0.00	0.33	0.35	0.37
Alcohol (b) (h)	0.00	1.22	1.27	1.30
Tobacco (b) (h)	0.25	3.16	3.22	3.22
Total	0.25	5.16	5.32	5.40
Other indirect tax revenues				
Luxury car tax (b)	0.00	0.18	0.21	0.21
Wine Equalisation Tax (b)	0.00	0.60	0.70	0.72
Total revenue	**-0.31**	**9.62**	**8.04**	**7.63**
Outlays				
GST business startup package	-0.50	0.00	0.00	0.00
First Home Owners' Scheme	0.00	-0.81	-0.83	-0.85
State rebates for off road diesel (b) (j)	0.00	0.58	0.63	0.66
Replacement of Diesel Fuel Rebate Scheme (b)	0.00	1.59	1.70	1.79
Diesel credits administered through GST (b)	0.00	-3.58	-3.84	-4.05
Reduced costs to governments (k)	0.00	1.07	1.14	1.20
GST policy/administration costs	-0.35	-0.35	-0.30	-0.29
Total outlays	**-0.85**	**-1.50**	**-1.51**	**-1.53**
National fiscal impact	**-1.16**	**8.12**	**6.54**	**6.10**

* A positive revenue or outlays number implies a positive impact on the budget balance.
(a) Includes GST revenue, the phased input credit on motor vehicles, credit for wholesale sales tax paid stock, and response effects associated with replacing the wholesale sales tax with a GST.
(b) Estimates for 1999-00 and 2000-01 reflect transitional impacts arising from the lagged collection of tax paid in respect of those financial years.
(c) Includes abolition of wholesale sales tax, collection of outstanding wholesale sales tax debt, the wholesale sales tax phase down in 1999-00 and response effects associated with replacing the wholesale sales tax with a GST.
(d) The estimates reflect an assumption that the States will reduce tax on gambling by an amount equivalent to that raised by the GST.
(e) Assuming abolition from 1 January 2001.
(f) The estimate assumes these stamp duties are removed from 1 July 2001.
(g) The estimate assumes these taxes are removed from 1 July 2000. The higher cost in 2000-01 reflects the Sydney Olympics.
(h) Refer to reconciliation table below for more detail on this measure.
(i) See also the impact on outlays of the removal of diesel fuel rebates. Refer to reconciliation tables below for more detail.
(j) As a consequence of the extension of the Commonwealth scheme for diesel fuel credits, the States will no longer need to pay rebates for off road diesel use.

(k) This reflects the removal of embedded wholesale sales tax and excises on purchases by Australian governments.

Revenue measures table: reconciliation of Commonwealth excise arrangements*

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Petrol excise (a)				
Conversion of business franchise fee replacement tax to Commonwealth excise	0.00	1.65	1.77	1.86
Unchanged retail petrol price	0.00	-1.21	-1.29	-1.36
Total	0.00	0.44	0.48	0.50
Diesel excise (a)				
Conversion of business franchise fee replacement tax to Commonwealth excise	0.00	1.10	1.18	1.24
Unchanged retail diesel price	0.00	-0.77	-0.83	-0.87
Replacement of Diesel Fuel Rebate Scheme	0.00	1.59	1.70	1.79
Diesel fuel rebate for remote power	0.00	-0.01	-0.01	-0.01
Excise credit to replace Diesel Fuel Rebate Scheme	0.00	-1.58	-1.69	-1.78
Conversion of States' diesel rebate to a Commonwealth excise credit	0.00	-0.58	-0.63	-0.66
Extension of excise credit scheme				
Extension to off road concession	0.00	-0.49	-0.52	-0.55
Rail and road transport @ 18 cpl	0.00	-0.93	-1.00	-1.05
Total	0.00	-1.67	-1.80	-1.89
Alcohol excise (a)				
Business franchise fee replacement tax	0.00	1.00	1.12	1.16
Abolition of business franchise fee replacement tax	0.00	-1.00	-1.12	-1.16
Change in excise to meet price targets (b)	0.00	1.22	1.27	1.30
Total	0.00	1.22	1.27	1.30
Tobacco excise (a)				
Conversion of business franchise fee replacement tax to Commonwealth excise	0.00	2.91	2.97	2.97
Per stick tobacco excise	0.25	0.26	0.26	0.26
Total	0.25	3.16	3.22	3.22

* A positive revenue or outlays number implies a positive impact on the budget balance.

(a) Estimates for 1999-00 and 2000-01 reflect transitional impacts arising from the lagged collection of tax paid in respect of those financial years.

(b) Alcohol taxation changes such that: a representative 4 litre cask of wine and representative carton of regular strength beer need not rise by more than the estimated increase in the CPI; a representative carton of low alcohol beer need not rise in price; a representative bottle of whisky remains about the same price; and a representative bottle of wine should only increase in price by about 3 per cent.

Revenue measures table: reconciliation of diesel excise arrangements*

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Commonwealth (a)				
Revenue				
Business franchise fee replacement tax	0.00	1.10	1.18	1.24
Unchanged retail diesel price	0.00	-0.77	-0.83	-0.87
Total	0.00	0.33	0.35	0.37
Outlays				
Replacement of Diesel Fuel Rebate Scheme	0.00	1.59	1.70	1.79
Diesel fuel rebate for remote power	0.00	-0.01	-0.01	-0.01
Diesel credits administered through GST				
Existing off road concession	0.00	-2.16	-2.32	-2.44
Extension to off road concession	0.00	-0.49	-0.52	-0.55
Rail and road transport @ 18 cpl	0.00	-0.93	-1.00	-1.05
Total	0.00	-2.00	-2.15	-2.26
Net budgetary impact	**0.00**	**-1.67**	**-1.80**	**-1.89**
States, Territories and local government (a)				
Revenue				
Business franchise fee replacement tax	0.00	-1.10	-1.18	-1.24
Outlays				
State rebates for off road diesel	0.00	0.58	0.63	0.66
Net budgetary impact	**0.00**	**-0.52**	**-0.55**	**-0.58**
National fiscal impact	**0.00**	**-2.19**	**-2.35**	**-2.48**

* A positive revenue or outlays number implies a positive impact on the budget balance.

(a) Estimates for 2000-01 reflect transitional impacts arising from the lagged collection of tax paid in respect of that financial years.

Revenue measures table: States, Territories and local government*

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Increases in revenues				
GST revenue (a) (b)	0.00	27.20	31.96	32.81
Growth dividend - States' share	0.00	0.20	0.30	0.40
Total	0.00	27.40	32.26	33.21
Reductions in revenues				
Reduced gambling taxes (b) (c)	0.00	-0.48	-0.56	-0.59
Abolition of FID/debits tax (b) (d)	0.00	-0.97	-2.39	-2.46
Abolition of business stamp duties (e)	0.00	0.00	-2.33	-2.41
Abolition of accommodation taxes (f)	0.00	-0.08	-0.06	-0.06
Abolition of business franchise fee replacement taxes	0.00	-6.65	-7.04	-7.24
Total	0.00	-8.19	-12.38	-12.76
Net increase in tax revenues	0.00	19.21	19.87	20.45
Changes in other revenues				
Abolition of Financial Assistance Grants	0.00	-18.18	-18.81	-19.46
Commonwealth grants to balance State budgets (g)	0.00	0.00	0.94	0.32
Total	0.00	-18.18	-17.87	-19.14
Change in net revenue	0.00	1.04	2.00	1.31
Change in outlays				
New States' responsibility toward local governments	0.00	-1.34	-1.38	-1.43
First Home Owners' Scheme	0.00	-0.81	-0.83	-0.85
Reduced costs to government from indirect tax reform	0.00	0.54	0.57	0.60
State rebates for off road diesel (b)	0.00	0.58	0.63	0.66
Payments to Commonwealth for GST collection (i)	0.00	-0.70	-0.30	-0.29
Total	0.00	-1.72	-1.32	-1.31
Impact on State, Territory and local government budgets (j) (k)	**0.00**	**-0.69**	**0.69**	**0.00**

* A positive revenue or outlays number implies a positive impact on the budget balance.

(a) Includes GST revenue, the phased input credit on motor vehicles, credit for wholesale sales tax paid stock and response effects associated with replacing the wholesale sales tax with a GST.

(b) Estimates for 1999-00 and 2000-01 reflect transitional impacts arising from the lagged collection of tax paid in respect of those financial years.

(c) The estimates reflect an assumption that the States will reduce tax on gambling by an amount equivalent to that raised by the GST.

(d) Assuming abolition from 1 January 2001.

(e) The estimate assumes these stamp duties are removed from 1 July 2001.

(f) The estimate assumes these taxes are removed from 1 July 2000. The higher cost in 2000-01 reflects the Sydney Olympics.

(g) Payment to States to offset negative early year impacts of GST implementation.

(h) This reflects the removal of embedded wholesale sales tax and excises on purchases by Australian governments.

(i) The payment in 2000-01 reflects costs associated with GST administration incurred in 1999-00 and 2000-01.

(j) Tax reform is projected to make a positive contribution to the net budgetary position of the States, Territories and local government in 2003-04 of around $0.37 billion. Beyond 2003-04 real per capita incomes will result in faster growth in indirect tax revenues than in the Commonwealth grants being abolished.

(k) The Commonwealth will provide a one year interest free loan to the States to offset the increase in their net financing requirement that arises in 2000-01 as a result of early year impacts of GST implementation. As a consequence of this arrangement, the net financing requirement of the States is unaffected by tax reform in each of the years 1999-00 to 2002-03. The impact on the headline balance for the Commonwealth is -$1.16 billion in 1999-00, -$5.45 billion in 2000-01, -$4.12 billion in 2001-02 and -$7.25 billion in 2002-03. The public debt interest costs associated with the loan are included in the Commonwealth public debt interest item.

Consistency
Reforms to business taxes

Overview

Australia's business tax system needs improving. Business structures and investments are taxed inconsistently, resulting in complexity, uncertainty, tax minimisation, unfairness and poor investment decisions.

The Government will undertake consultation on business tax reform on two fronts. Firstly, on the implementation of the taxing of trusts like companies under redesigned company tax arrangements — while preserving income splitting through trusts and avoiding an inappropriate impact on existing trusts — and to extend the company tax arrangements to other entities offering limited liability. Secondly, to explore reform of the treatment of business investments — and the prospect that provides for achieving a reduced company tax rate.

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The problem

The system reflects a bygone era

Business tax is a confused labyrinth — a poor foundation and no framework for development

Business taxation is concerned with taxing investments in physical assets (like machinery and property) and financial assets (like bonds). It is also concerned with taxing the collective vehicles or 'entities' (like companies and trusts) through which these investments can be made.

The current business tax law is outdated and becoming beyond repair. It is a product of continual 'catch-up' amendment of a narrow legislative framework founded in the 1930s — in part in response to the increasing use of trusts and other entities for a wide variety of business purposes and in part because of a succession of responses to deficient treatment of changing values of physical and financial assets.

The continual amendments since the 1930s have been unsystematic and *ad hoc.* As a result, the provisions impose compliance and administrative difficulties and set up a wasteful tread-mill of avoidance loopholes and amendments — which, in turn, open up further loopholes.

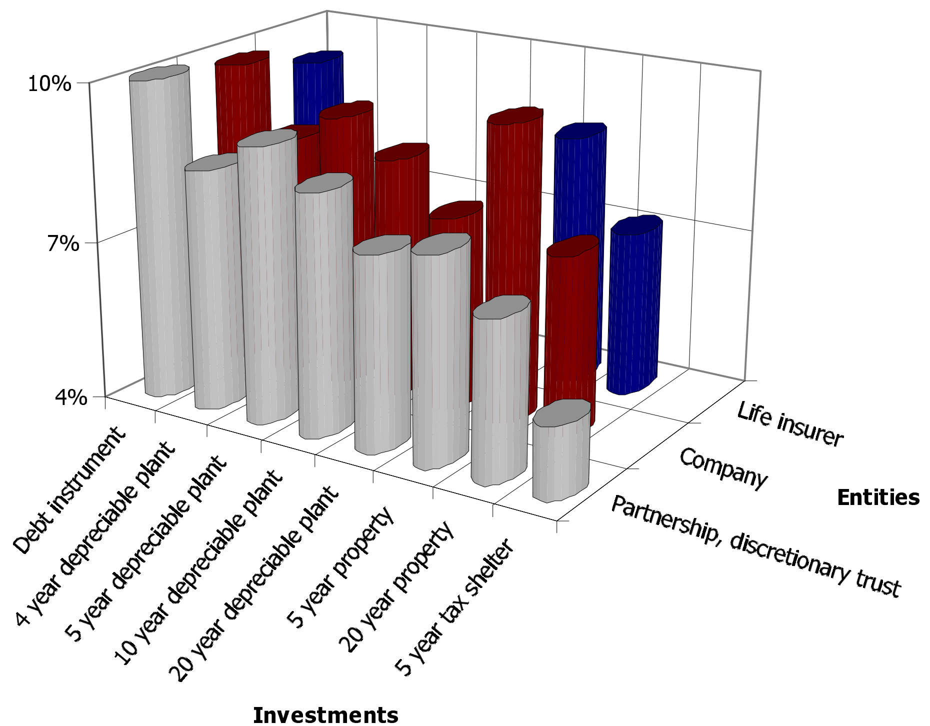
The overall result is a business tax system that is complex, unstable and too often uncertain in its application and its effect. The world has changed dramatically since the 1930s and the structure of business tax law has been found wanting.

An irrational system promotes inequity and misdirected activity

The fundamental problem is that there is inconsistent taxation treatment of business entities and the investments they conduct (Figure 3.1). There are large and variable gaps between tax treatment and commercial reality.

Exactly the same investment gets very different tax treatment if conducted through different collective business structures (eg companies, trusts or life insurers). Underlying a particular market-driven after-tax return are very different pre-tax returns from different types of investments.

Figure 3.1:
Inconsistent treatment of entities and investments yields fundamental distortions



This diagram shows the pre-tax return that different investments need to make in order to earn the same after-tax return of 5.3 per cent for an individual on a 47 per cent tax rate.

These outcomes are most unfair. Wealthier individuals with access to legal and accounting advice can target particular investments and structures to take advantage of the differences in tax treatment — and thus minimise the amount of tax they pay. The rest of the community subsidises the wealthier investor.

Moreover, with tax and commercial considerations often out of line, investment activity is misdirected towards less productive pursuits — activities with low pre-tax returns such as those offering 'tax shelter' opportunities (Figure 3.1). Investment decisions are taken more on the basis of tax-preferred status than economic worth. A bias towards activities generating low pre-tax returns reduces Australia's productivity, Gross Domestic Product (GDP) performance and job creation.

Figure 3.1 highlights the two dimensions of business tax requiring reform: business entities and the investment base.

Taxation of business entities is inconsistent

The taxation of business entities requires reform across three key problem areas: inconsistent entity treatment; inappropriate taxation of company groups; and inconsistent treatment of distributions.

Differential treatment of entities produces unfair outcomes

Under current law, vastly different treatment is accorded investment income channelled through different entities. The treatment is different both between the various entities and at the individual investor (eg shareholder) level.

Companies, fixed trusts, and discretionary trusts all offer investors the prospect of limited liability — shielding them from full personal liability for making good the entities' financial liabilities. And yet there is very different treatment across these entities of distributions out of profits freed from taxation by tax preferences ('tax-preferred' income). Such distributions by *companies* (ie unfranked dividends) are taxed in the hands of individual resident shareholders. In the case of *fixed trusts* these distributions are generally taxed with a delay when the interests in the trust are sold. With *discretionary trusts* the distributions are not taxed at all. The beneficiaries of discretionary trusts enjoy 'the best of both worlds', benefiting from both limited liability and the flow-through of tax preferences.

Sole traders and partners in partnerships are able to access tax-preferred income but they bear liability for losses of their businesses (unless in limited partnerships); that is, they do not have limited liability arising from the entity.

Some *co-operatives* are taxed differently again from companies under complex arrangements that can result in different outcomes depending on the timing of distributions.

The treatment of life insurance investments is inequitable as the returns are unlikely to be taxed at the policyholder's marginal tax rate. Different tax rates apply to *life insurers* depending on the type of institution offering the policy, the nature of the policy and the investor.

Special treatment of company groups adds to costs and compromises the system's integrity

Within wholly-owned company groups the transfer of tax losses is allowed, as is capital gains tax (CGT) rollover relief for asset transfer. But other tax benefits cannot generally be transferred.

Companies are able to achieve unintended tax benefits from the present grouping provisions (together with the 'section 46' rebate on

inter-corporate dividends). Group companies — as well as related companies with less than 100 per cent common ownership — are able to create artificial losses by cascading losses through the company chain and by shifting assets between subsidiaries at values higher or lower than their market values. Group companies are also able to create taxation benefits by manipulating transactions between companies in the group.

Anti-avoidance provisions to address these activities are complex — but have not been able to keep up with the growing use of tax strategies. The integrity of the company tax system suffers as a result. Moreover, the growing complexities in the law are imposing large compliance and administrative costs. Company groups often face heavy compliance costs to undertake even minor restructuring.

The inconsistent treatment of company distributions can penalise shareholders

Within the company tax system itself, the various ways of distributing profits from companies (through dividends, share buy-backs and on liquidation) are currently treated inconsistently. In some circumstances, shareholders may be penalised through the imposition of two layers of taxation on the same income — with possible adverse effects on the functioning of capital markets.

Moreover, refunds are not available to resident taxpayers who have insufficient non-dividend income to absorb all the imputation tax credits attaching to their company dividends. This disadvantages low income shareholders, including self-funded retirees. They may face the company tax rate on dividend income rather than their own marginal tax rates.

There are also problems in identifying the mix of contributed capital, taxed profits and tax-preferred profits in company distributions. Anti-avoidance provisions to deal with the substitution of contributed capital for dividends have been recently introduced — but they, necessarily, do not address the underlying structural issue.

Taxation of business investment lacks a coherent framework

The 1930s law ignored a critical issue: the changing value of assets/liabilities

The original 1930s legislative foundation focused on the recurrent income yielded by assets — such as annual revenue from the sale of goods and services produced by physical assets or annual interest on

financial assets. It did not generally take into account the effect on income of the changing values of the assets themselves. Since then, neither with physical assets nor financial assets/liabilities has the tax treatment of changing asset values been implemented within a consistent and coherent framework driven by sound and clearly enunciated principles.

As a result, the tax treatment of changing asset (and liability) values requires consideration.

Physical assets

There are several inconsistent regimes for the treatment of amortisation of *physical assets*: plant and equipment; buildings and structures; and certain assets used in the resources sector.

The write-off allowances of many *depreciating physical assets*, the treatment of gains on *assets that have appreciated* in value and the various ways that *trading stock* is valued invariably keep the annual tax values of these assets out of kilter with commercial value.

Other forms of capital expenditures necessarily incurred by businesses receive no taxation write-off — such as costs of forming or relocating a business. Reflecting this tax treatment, they are referred to as *blackhole expenditures*.

Financial assets/liabilities and intangibles

The poor tax treatment of changing values of *financial assets and liabilities* distorts financial and risk management decisions, invites tax abuse and inhibits innovation. Poor asset treatment aside, even the deductibility of annual interest payments is unclear, inconsistent and uncertain.

The provisions dealing with taxation of *leases* over wasting assets are not consistent in effect and often involve costly administrative complexities. Capital gains taxation of lease premiums does not reflect changing values over the whole period of the lease. Similar problems arise with the up-front payment for *rights* — such as the right of access to others' assets. More generally, *fixed life intangible assets* (eg spectrum licences, intellectual property and franchise fees) are taxed inconsistently.

Use of accounting principles

Some expenditures are treated as recurrent (attracting immediate deductibility) when the associated income is to be earned over future years, sometimes with many years' delay. This is despite the fact that *accounting principles* would view the expenditure as acquiring an asset (with write-off depending on its subsequent change in value).

The goal

The tax treatment of business entities and investments is flawed. The piecemeal approach to changing the system has not worked in the past and if continued will add to instability, uncertainty and complexity. Systemic problems require systemic solutions. A comprehensive approach to business tax reform is required driven by clear, sound principles and involving a general move towards greater commercial reality.

This approach offers the prospect of a stable, simpler and more coherent business tax system with greater integrity — a system providing fairer, more equitable outcomes, less scope for tax avoidance and the basis for more robust investment decisions and a lower company tax rate.

Taking this approach to reform should lead to improved competitiveness, greater productivity, higher GDP growth and more jobs.

The strategy

The strategy is to:

- Pursue reforms on two fronts: *business entities* and *business investments*.
- Consult on a framework for taxing trusts like companies, as well as transitional and implementation details — and on the extension of that framework to other *business entities.* In the interim, introduce immediately provisions that address tax minimisation activity through the use of trusts.
- Consult on the extent of reform of *business investments* with the prospect of further CGT relief and of moving towards a 30 per cent company tax rate to the degree that progress is made. Extend immediately the arrangements which provide CGT 'rollover' relief and retirement exemption for small business.

The plan

Reforming the taxation of business entities

Taxing trusts like companies
Addressing tax minimisation through complex trust structures
Moving towards consolidated group taxation
Achieving consistent treatment of entity distributions

Taxing trusts like companies — under redesigned company taxation

It does not make sense for exactly the same investment to attract very different tax treatment simply because it is put through a trust rather than a company.

The Government will consult on the achievement of consistent taxation of discretionary and fixed trusts like companies under a clear, fair and simple regime of redesigned company taxation. The Government intends that the regime commence in the 2000-01 income year.

Key features of the redesigned company tax arrangements are:

- A simplified imputation system involving full franking of all profits paid to individuals or other entities outside consolidated groups. The full franking would involve the taxing of all distributed profits at the entity level — with all distributed profits then having attached imputation credits for the tax already paid.
- Refunds of excess imputation credits for resident individual taxpayers and complying superannuation funds. Special arrangements would apply to *registered charitable organisations* (see below).
  - — Trusts would be able to continue to realise the benefits of income splitting among beneficiaries.
  - — The refunds would mean that each individual beneficiary would be taxed on trust distributions at their marginal tax rates. The same would apply to individual shareholders.
- Transitional arrangements to avoid an inappropriate impact on existing trusts.

Taxing trusts like companies means the imposition of tax on distributions by trusts of tax-preferred income. The transitional arrangements need to recognise the difference in the current tax treatment of the tax-preferred income of discretionary trusts and fixed trusts. With discretionary trusts, tax-preferred income can at present be distributed tax free to individual beneficiaries. With fixed trusts, however, distributions of tax-preferred income are already taxed — although usually not until the beneficiaries' interests in the trusts are

sold because the distributions of tax-preferred income reduce the CGT cost base of those interests.

Despite these differences between discretionary and fixed trusts, the transitional conversion of tax-preferred income into contributed capital would maintain the current treatment of that income with both types of trust. It would maintain tax free status with discretionary trusts and CGT taxation with fixed trusts.

The key components of the transitional arrangements for discretionary and fixed trusts are as follows.

- Current tax status would be maintained for distributions out of the following amounts from businesses and assets held in trusts at the commencement of the new regime (including gains accrued after the start date):
  - — realised gains on pre-CGT assets;
  - — realised inflationary gains on post-CGT assets; and
  - — realised gains subject to the exemption of 50 per cent of CGT otherwise applying to goodwill on the sale of a small business.
- Current tax status would be maintained for distributions by trusts out of other tax-preferred income earned prior to the new regime (excluding unrealised gains on trust assets) — as well as prior taxed income.

Beyond these transitional arrangements, some features of current arrangements would be retained on an ongoing basis. After the commencement of the entity tax regime:

- current tax status would be maintained for distributions out of realised profits freed from tax by the small business 50 per cent goodwill exemption for new businesses in existing and future trusts; and
- income distributed from existing and future trusts would continue to attract the primary producer averaging provisions and the farm management deposit arrangements.

Apart from primary producer averaging, maintenance of current tax status for distributions out of the above profits would be maintained by adding the amounts to contributed capital — usually at the time of sale of the associated assets. This approach and the transitional arrangements should mean that asset valuation should not be a significant issue at the start of the new regime.

The introduction of entity taxation arrangements would mean that trust distributions to charitable funds and organisations are made from post-tax income. In order not to penalise genuine charities, provisions would be included in the law to establish a registration process for such organisations. Only those organisations listed on the register would be tax exempt or able to qualify for gift deductibility. Registered

organisations would also be allowed to claim refunds of excess imputation credits for tax paid at the trust level on donations to them by way of trust distributions. These refunds would maintain the current net tax position of such donations.

Reaping the benefits of a consistent regime

Achieving consistency of treatment across companies and trusts under these redesigned company tax arrangements would provide simplicity, clarity and fairness in treatment. It would also address techniques that have come to light through the High Wealth Individuals project which take advantage of highly complex structures.

The refunds of excess franking credits would provide a fairer outcome for low income people — in a way consistent with the original objectives of the full imputation system. The overall tax paid on profit distributed by a company or trust to low income resident individuals would reflect their marginal tax rates. They would not be disadvantaged simply because tax was first paid on the profit by the company or trust. The benefits of income splitting would apply consistently across all companies and trusts.

The full franking of dividends would simplify considerably the operation of the imputation system, removing the need to distinguish between franked and unfranked dividends. The current complex anti-avoidance provisions to address the streaming of franked and unfranked dividends could be repealed.

Full franking also underpins the design of the arrangements, discussed later, that would achieve consistent treatment of distributions of profits and capital. And its introduction would minimise the need for specific anti-avoidance measures through the entity chain outside the full consolidation regime being considered for entity groups.

The Government intends to broaden the benefits of these redesigned company tax arrangements by applying them to other business entities offering limited liability to their owners: limited partnerships, co-operatives and life insurers. This would mean that life insurers' income would be taxed uniformly at the company tax rate (with imputation credits for investment policyholders). Co-operatives are already taxed like other companies if less than 90 per cent of their business is with their members. Limited partnerships, too, are already taxed as companies (although their public company status will be the subject of consideration in the consultative phase).

Other partnerships (and sole traders) would not be part of the entity taxation regime. The flow-through of tax preferences in these cases is consistent with the full personal liability applying in relation to the financial liabilities of the business activities involved.

Refining the framework through a process of consultation

While it is the Government's intention to introduce the framework outlined above to achieve consistent entity taxation, the Government considers it important for consultations to be pursued on that framework, as well as associated transitional and implementation details. Consultations will be particularly important in relation to: the full franking arrangements, the refunding of imputation credits, international considerations, other trust issues and the taxation of life insurers.

i. How full franking arrangements would work

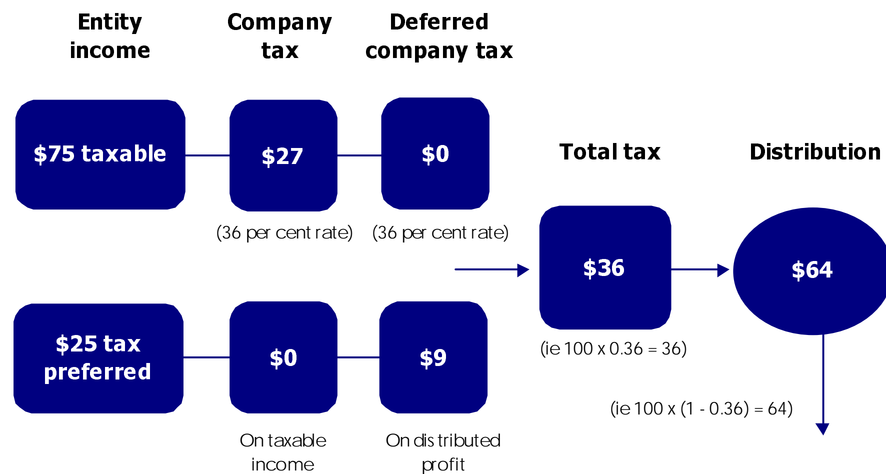
There is considerable complexity in the present system caused by dividends being either franked or unfranked depending on whether they are paid out of taxable income or not. Virtually all company profits are taxed. But only taxable income is subject to company tax (with distributions of these taxed profits being franked). Other tax-preferred profits are taxed in the hands of individual resident shareholders as unfranked dividends when distributed.

Under a full franking system, taxable income would, as now for companies, be subject to company tax. In contrast to current arrangements, however, distributions of other profits would be taxed (at the company tax rate) at the entity level, rather than at the shareholder level. This deferred company tax would subject distributed tax-preferred income to tax at the entity level so that all distributions of profit would then be franked. Company tax paid would then be creditable under the imputation system to resident individual shareholders, beneficiaries, members of co-operatives or policyholders. These individuals would be paid the excess franked credit where their marginal tax rate is less than the company rate.

Deferred company tax would not only apply to dividends paid to individuals and superannuation funds. It would also apply to distributions of tax-preferred income from one entity to another (other than in the case of consolidated groups) — with arrangements to ensure that double taxation did not occur through the entity chain.

Figure 3.2 shows the operation of the full franking arrangements. At the current 36 per cent company tax rate, $100 of company or trust income would give rise to a potential franked dividend of $64 and $36 of company tax (regardless of the mix of taxable and tax-preferred income in the $100).

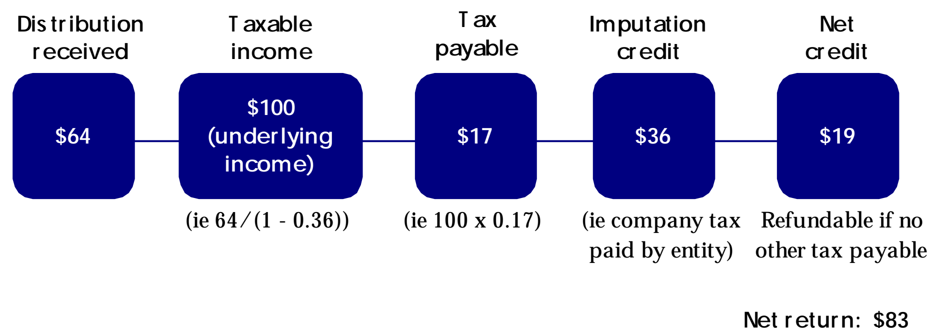
Figure 3.2:
How imputation would work at the entity level



ii. How the refunding of imputation credits would work

Taxable resident recipients of franked dividends would be assessed on the cash dividend ‘grossed-up’ by the attached imputation credits — with the credits then creditable against tax payable. In Figure 3.3, the 17 per cent marginal tax rate recipient of a $64 dividend has $17 tax payable on $100 of grossed-up dividend and receives a tax credit of $36.

Figure 3.3:
17 per cent marginal rate taxpayer



Both resident individual taxpayers and complying superannuation funds would be eligible for refunds of excess imputation credits where other tax payable cannot absorb them. The taxpayer in Figure 3.3 would receive a refund of $19 if he or she had no tax payable on other income. That would ensure that the imputation system operates as it should — imposing overall tax on distributed profits at the marginal tax rates of resident individual taxpayers. And this would be of major benefit to low income earners, including self-funded retirees, who are unable to fully utilise imputation credits because they have insufficient taxable income to absorb them. Under the entity tax regime this would

benefit not only low income shareholders but also low income investors in equity unit trusts and life insurance policies.

These arrangements should not change significantly the overall tax payable over time by resident beneficiaries in relation to profits distributed by fixed trusts, including cash management trusts. Nevertheless, the timing of tax payments by trusts under the proposed pay as you go system (Chapter 4) and of refunds of excess imputation credits for low marginal tax rate beneficiaries will be an important design issue for consultation.

iii. How consequential changes would be made in relation to investment in Australia by foreign investors and offshore investment by Australian residents

The Government is committed to maintaining the attractiveness of Australia as an investment location and a financial centre in the context of the changes outlined above — while ensuring foreign investors pay their fair share of tax on Australian source income. This commitment is made recognising that the deferred company tax under the entity tax regime would impose tax at the company rate on dividends paid out of tax-preferred income to foreign investors. Currently those dividends attract dividend withholding tax, generally at 15 per cent. Consequential changes to international taxation arrangements would therefore be necessary. Relevant too is the possibility of moving towards a company tax rate of 30 per cent as a result of the proposed consultative process with industry on reforms to the business base.

The Government is also committed to ensuring that offshore investment — including through non-resident trusts — is not used by Australian residents to avoid paying their fair share of tax.

The process of consultation in relation to changes that would be needed to international taxation arrangements under the entity tax regime will be set against the above commitments and the following principles.

In relation to *investment in Australia by foreign investors*, the principles are to ensure that: interest on Australian debt continues to be subject to the current 10 per cent interest withholding tax (IWT) arrangements — including the current range of IWT exemptions; total tax borne on profits distributed to foreign investors is in line with the company tax rate; maximum possible creditability overseas of Australian tax is achieved; the Australian taxation system does not unduly impede offshore income passing through Australia to non-residents (‘conduit’ income); and the taxation of branches of foreign entities is in line with the entity tax regime.

In relation to *residents' foreign source income*, the principles are to: tax residents' interests in non-resident trusts to ensure outcomes consistent with the entity tax regime; and strengthen the accrual taxation rules and transferor trust arrangements that apply to foreign trusts to address

exploitation of current deficiencies. Changes implemented in line with these latter principles should ensure that Australian residents cannot avoid paying their fair share of tax through the use of foreign trusts.

iv. How other issues arising from taxing trusts under the entity tax regime would be handled

The principle guiding the consultation process on transitional and implementation details will be that trusts should, as far as possible, be taxed like companies — excluding the special arrangements outlined above. Thus, distributions 'out of' unrealised profits would be subject to tax and provisions covering private company loans to shareholders would be extended to discretionary trusts and closely held fixed trusts. While a wide range of additional issues will need to be discussed, particularly in relation to discretionary trusts, the coverage of consultation will include the following areas.

Which trusts should be excluded from the entity tax regime?

The Government envisages that certain trusts would be excluded from the entity tax arrangements and attract tax in line with the current treatment of discretionary trusts.

Consultation will be on the basis that the general principle for exclusion would be where a trust has been created and settled only as a legal requirement or subject to a legal test or sanction. In these cases, the beneficiary (and parent/guardian) would usually not have any real choice about using the trust.

On this basis, trusts excluded would include constructive trusts (eg imposed by a Court in relation to embezzled money) and trusts arising in a range of circumstances where the sole beneficiary is subject to a legal disability or is legally incapacitated.

How should trust losses be treated?

Under the recent trust loss measures, trusts generally cannot allow trust losses to be transferred or used by other entities — although losses may be used within a family group.

The principle of treating trusts as much as possible like companies means that fixed trusts would continue to access their own past year losses if they meet a 50 per cent continuing ownership test. Discretionary trusts would need to meet the ownership, control and pattern of distributions tests in the recent trust loss measures. Trusts would also be able to utilise losses under the same business test applying to companies.

Similarly, discretionary and fixed trusts would be part of the group consolidation regime under consideration. Thus the ability to use losses within a family group of entities would be formalised within a consolidation regime.

Discretionary trusts could be part of a consolidated group of trusts and companies if each trust and company were only able to distribute to the members of the same family — as defined in recent trust loss measures.

v. How the entity tax regime would apply to life insurers and their policyholders

Extension of the entity tax regime to life insurers would allow the wide variety of tax rates currently faced by life insurers to be removed and their investment policyholders to attract tax at personal marginal tax rates.

Consultation with the life insurance, friendly society and superannuation industries will include the technical and transitional issues associated with implementing these arrangements.

How would life insurers be treated?

Under the entity tax regime, from the 2000-01 income year, the company tax rate would apply to a life insurer's income and deductions generated in relation to:

- ordinary life insurance business — presently taxed at a separate trustee tax rate (39 per cent for life insurance companies and 33 per cent for friendly societies);
- policies held by superannuation funds — both complying (currently attracting 15 per cent) and non-complying (currently 47 per cent); and
- contractual obligations on annuity contracts — with a deduction allowed for the 'interest' component of annuity payments and associated expenses. Income from this business is currently exempt and associated deductions are not allowed.

All profit from funds management, underwriting and other life insurance and annuity business (largely untaxed currently) would also be taxed at the company tax rate. The friendly society tax rate would remain at the current 33 per cent rate until 2000-01. The present treatment of Retirement Savings Accounts would be retained.

Consistency would require that the income underlying the pension and annuity business of superannuation funds be taxed at the 15 per cent rate (with deductions allowed for the 'interest' component and associated expenses). This change would not affect the tax treatment of recipients of pension or annuity payments by superannuation funds.

These reforms would improve the efficiency of the financial system and further the objectives of financial system reform. They would also improve the certainty of the taxation treatment that applies to life insurers. Life insurers, for example, would no longer need to undertake complex and costly allocations of income and deductions into different tax 'baskets'.

How would life insurance policyholders be treated?

Currently, life insurance income distributed on investment policies held for more than ten years is exempt in the hands of policyholders. It is, however, taxed to the life insurer — at 39 per cent for a life insurance company and 33 per cent for a friendly society. That disadvantages low marginal tax rate policyholders and advantages high marginal tax rate policyholders. Furthermore, assessment and rebate arrangements applying to income distributed on policies held for less than ten years also do not result in that income being taxed at policyholders' marginal tax rates.

Under the entity tax regime, income assigned to investment policies (not risk policies) would attract tax at the marginal tax rates of policyholders regardless of the period of investment (including with policies held for more than ten years). This would mean that investment policies would be treated in the same manner as company dividends and income from unit trust investments.

Bonuses (including terminal bonuses) assigned to individual investment policies would have imputation credits attaching to them for the tax paid by the life insurer. These credits (which would be refundable) would result in investment income being subject to the policyholder's marginal tax rate in the same year that a bonus is assigned to the policy.

Those with a marginal tax rate less than the company rate (including complying superannuation funds) would attract net credits to reduce tax on other income, or be refunded. The availability of refunds would ensure that no more than 15 per cent tax applied to the income of superannuation funds. Other policyholders would attract additional net tax on their grossed-up bonuses to the extent that their marginal rate was higher than the company rate. With tax being potentially payable on bonuses not received in cash, policyholders would have the choice of being taxed on the bonuses either when they are assigned to their policies or when they are ultimately distributed.

Similar treatment would apply to returns from investment-linked policies as income is distributed to policyholders.

As a transitional measure, individuals holding policies written before the commencement of the entity tax regime would continue to attract the current treatment of their bonuses after commencement: exemption for policies held for more than ten years and assessment and rebate arrangements for policies held for less than ten years.

Addressing tax minimisation through complex trust structures

The entity tax regime would address a wide range of tax minimisation opportunities available through the use of trusts — opportunities driven by the different treatment of trusts and companies.

Pending the introduction of the entity tax regime, the Government has decided to introduce an anti-avoidance measure aimed at such practices. Legislation to implement this measure will be enacted with effect from the date of release of this package.

Trustees to identify ultimate beneficiaries

The Tax Office has evidence that certain taxpayers are using complex chains of trusts to minimise tax. There are many legitimate reasons for trust structures containing multiple trusts. Nevertheless, some taxpayers are using multiple trust arrangements to make it difficult for the Tax Office to piece together the trail of distributions from trust to trust to establish tax liability.

A special anti-avoidance rule will be introduced, with immediate effect. It will require the identification by trustees of discretionary and closely held fixed trusts of the individual or company beneficiaries, and their tax file numbers if they are residents, that are ultimately entitled to trust distributions. This will apply regardless of the number of trusts through which the distributions may pass. The measure will help establish tax liabilities by providing an administrative audit trail.

Details of the measure are provided separately.

Moving towards consolidated group taxation: a process of consultation

The complexity of tax arrangements facing company groups and the associated high compliance costs need to be addressed — as does the ability of group companies to gain unintended tax advantages from the current grouping concessions and by dealing among themselves.

The Government's intention to bring trusts within the company tax framework makes it even more essential that these problems be addressed.

The Government intends to consult on a move towards allowing groups of companies, trusts and co-operatives to consolidate their tax position. A group would only prepare one tax return and have a single franking account, one capital loss account and one revenue loss account.

Eligible groups would be 100 per cent wholly owned Australian resident companies, co-operatives and fixed trusts. A consolidated regime for discretionary trusts would encompass groups of family trusts (and companies).

Consultation with the business community will be undertaken on the basis of the following high level principles:

- *groups treated as a single entity* — dealings between companies/trusts in a group would be ignored for the purposes of the group's tax assessment;

- *consolidation optional for whole group* — eligible groups would be able to make an irrevocable choice to consolidate the entire group or to have all entities in a group subject to separate taxation treatment;
- *repeal of current group concessions* — the group concessions would be replaced by the consolidation arrangements;
- *losses and franking balances on entry* — companies or trusts entering a consolidated group would be able to bring franking account balances into the group and also carry-forward losses on a basis consistent with the principles underlying existing tax law;
- *equity interests on exit from consolidation* — exit provisions will determine equity cost bases for entities leaving a consolidated group by reference to asset cost bases and equity cost bases on entry and to any cost base adjustments necessary during consolidation; and
- *losses and franking balances on exit* — in recognition of the pooling of franking credits and losses during consolidation, companies or trusts exiting a continuing group would be unable to take with them carry-forward losses or franking account balances. The losses and franking account balances would stay with the continuing group.

A wide range of issues will need to be analysed and discussed against this set of principles including, importantly, arrangements for the transition of existing companies and trusts into a consolidation regime.

There is a strong incentive to devise workable consolidation arrangements. In the absence of a consolidation regime, solutions to current problems would need to be sought through extensive value shifting and loss cascading rules to apply within entity groups.

Arrangements will be needed to address value shifting and cascading of losses in related groups ineligible for, or remaining outside, consolidation. Those arrangements would, however, be much simplified by the application of deferred company tax down the company/trust chain outside consolidation.

Achieving consistent treatment of entity distributions

Current inconsistencies and uncertainties need to be removed in the treatment of the various ways of returning contributed capital and profits to shareholders: dividends, share buy-backs and by way of liquidation. This would complement changes in the corporations law in relation to share buy-backs and returns of capital. The reformed arrangements would apply to trusts (and co-operatives) in the entity tax regime.

The benchmark for consistent treatment across dividends, share buy-backs and liquidations is to be the current treatment of dividends. The central element of relevance here is the capital loss allowed to the shareholder who buys shares cum dividend and sells when the shares

fall in value post dividend. That capital loss is needed to ensure that double tax does not occur, over time, on retained company income.

Crucial to the proposal for consistent treatment of distributions is the deferred company tax which is a key element of the entity taxation regime. Allowing capital losses to offset double taxation requires tax to be paid on the associated dividend distributions.

Consultation, against the dividend treatment benchmark, will focus on implementing arrangements to achieve consistent treatment across share buy-backs and liquidations, as well as the distribution of profits and contributed capital. Consultation will be on the basis of a regime which involves: retaining the current treatment of off-market buy-backs; addressing double taxation when a company buys back shares for cash 'on market'; determining the split between taxed/tax-preferred profits and contributed capital in the buy-back price on the basis of the 'slice' of the company involved; treating all profits distributable at liquidation as dividend distributions (without affecting the current exclusion of profits from the sale of pre-CGT assets in pre-CGT companies); and introducing a general 'profits first' rule whereby distributions outside buy-backs would be treated as dividends so long as profits were available.

A profits first rule, together with the deferred company tax, would ensure that the current complex dividend streaming provisions would no longer be needed. Franking credit trading provisions, on the other hand, are designed to address arbitrage opportunities such as those between non-residents and tax exempt locals (who cannot benefit from imputation credits or capital losses) and taxable residents.

There would be a transitional measure relating to the application of profits first rule to trusts taxed under the entity tax regime. The transitional arrangements discussed earlier mean that for assets or businesses held in trusts prior to the commencement of the regime, realised gains on pre-CGT assets, realised inflationary gains on post-CGT assets and realised gains covered by the 50 per cent goodwill exemption would be converted to contributed capital. Under the transitional measure, these converted gains would not be subject to the profits first rule if they are distributed in the year they are realised.

Reforming the taxation of business investments

Consulting on the treatment of business investments

The Government proposes consultation on possible reform of the investment base. This consultation will be undertaken bearing in mind four considerations:

- the need to encourage business development with an internationally competitive tax treatment of business investments;

- the potential benefits of bringing tax value and commercial value closer together;
- the goal of moving towards a 30 per cent company tax rate; and
- the need to achieve overall revenue neutrality.

Any move towards a 30 per cent rate will depend on the outcome of consultation with business on the extent and nature of reform to the business investment base. That decision will be strongly influenced by business support for such changes.

Reform consultation will focus on the poor treatment of changing asset (and liability) values currently in the income tax law.

There are three key areas to be considered: physical assets; financial assets and liabilities; and the potential use of accounting principles.

Physical assets

The Government sees scope for the taxation of investment in physical assets to be more in line with commercial practice. Hence, the following issues relating to physical assets require consideration:

- capital write-off allowances;
- balancing adjustments on disposal (where sale price differs from tax written-down value);
- trading stock valuations;
- CGT indexation and averaging; and
- scope to unify capital write-off provisions and roll the currently separate CGT provisions into them.

In this context, a number of specific reforms to CGT may be open, including: capping the rate of tax applying to capital gains for individuals at 30 per cent; extending the CGT roll-over provisions to scrip-for-scrip transactions; and introducing a $1,000 per annum CGT tax-free threshold for individual taxpayers.

The treatment of 'blackhole' expenditures — such as feasibility studies and export market development costs — is also an important issue for examination.

The base broadening required to achieve a 30 per cent company tax rate would almost certainly require a significant paring back of current accelerated write-off arrangements. However, consultation will focus on the desirability of such changes given the differential impact that reduced write-off concessions would have across industry sectors.

Financial assets/liabilities and intangibles

Closer alignment of tax value and commercial value is important with financial assets and liabilities in today's dynamic and innovative

financial markets. On this basis, consultation will involve consideration of achieving greater consistency and clarity in the treatment of financial transactions, including prepayments, leases, rights over assets and fixed life intangibles. Greater recognition of commercial valuation methods should allow significant simplification of the proposals canvassed in the *Issues Paper on the Taxation of Financial Arrangements* released in December 1996 — particularly in relation to hedging, foreign currency gains and losses and debt/equity definitions in the context of an optional mark-to-market regime.

Scope to address current inconsistencies and uncertainties associated with the tax deductibility of interest will also be discussed.

Use of accounting principles

There may be scope over time for a closer alignment of the tax law and accounting principles. Use of accounting procedures for tax purposes could only be contemplated where that does not compromise the integrity of the tax system. But where common use is possible, compliance costs should be able to be reduced substantially.

Compliance cost savings have been raised in the area of financial arrangements in the 1996 *Issues Paper on the Taxation of Financial Arrangements* and in subsequent consultation on the paper. Accounting principles dealing with the timing of benefits or income from business expenditure may be able to help overcome uncertainties and inconsistencies in the tax law concerning the distinction between *recurrent* expenditure and *capital* expenditure.

Scope to dovetail accounting principle with tax principle in other areas will be further pursued during the consultative process.

Extending CGT rollover relief and retirement exemption for small business

Currently land and buildings that are used in a small business operation but which are held in a trust or company separate from the business attract neither the CGT rollover relief nor the retirement exemption for small business. That is because these assets are classed as 'passive' assets when held in a separate entity. A typical example is a primary producer business operated through a partnership but with associated land and buildings held in a trust controlled by the partners.

The Government has decided to extend the CGT rollover relief and retirement exemption to include land and buildings integral to a business when these assets are owned separately — rather than being owned directly by the entity through which the business is operated. The new provisions will apply where the taxpayers owning and controlling the land and buildings are substantially identical to those controlling the business.

The new provisions will have effect from the date of release of this package. Details of the measure are provided separately.

Revenue measures table: business tax*

	1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Consistent treatment of entities (a)				
Trusts (b)	0.07	0.90	0.76	0.43
Deferred company tax (c)	0.07	0.19	0.39	0.42
Refundable imputation credits (d)	0.00	0.00	-0.55	-0.55
Life insurers (e)	-0.02	0.59	0.67	0.65
Share buy-backs and liquidations	0.00	0.00	-0.30	-0.30
Net budgetary impact	**0.12**	**1.67**	**0.97**	**0.65**

* A positive revenue number implies a positive impact on the budget balance.

(a) Costings based on the framework specified in Chapter 3, recognising that this framework will form the basis for public consultation. The costings do not include the effects of the proposed group consolidation regime and associated loss provisions.

(b) Includes taxation of trusts like companies under the redesigned company tax arrangements (including the timing impact of the new payment arrangements), as well as both deferred company tax and refundable imputation credits associated with trust distributions. Also included is the effect of changes to the treatment of non-resident trusts and the introduction of an anti-avoidance measure.

(c) Includes deferred company tax on unfranked dividends paid by companies to residents (less refundable imputation credits associated with such dividends) and additional revenue from deferred company tax on company distributions to non-residents.

(d) Includes refundable imputation credits associated with franked dividends paid by companies.

(e) Includes the effect of changed treatment of the life insurance and annuity business of life companies and friendly societies (including changed treatment of policyholders and retention of the 33 per cent friendly society tax rate until 2000-01), as well as the pension business of superannuation funds.

Simplicity
Reform to tax administration

Overview

Business faces a confusing maze of obligations, many tax instalment systems to do the job of one and there is not enough systemic pressure on the cash economy.

Arrangements will be changed so that businesses need only one number to deal with the whole of government, payment and reporting is made simpler and opportunities for tax avoidance and participating in the cash economy are reduced.

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The problem

Business has to deal with too many bodies

Business, especially small business, has highlighted the cost of dealing with numerous regulatory bodies across the three tiers of government. Tax systems require business taxpayers to use different identification numbers for different tax types, on top of the identifiers used for other government regulatory requirements.

This was highlighted by the report of the Small Business Deregulation Taskforce (the Bell Report), which was established by the Government to examine the impact of regulation and red tape on Australian business.

Business payment systems are inflexible, arbitrary and out of alignment

The two systems (company instalments and provisional tax) under which businesses currently pay income tax by instalments provide little flexibility for payments to reflect current trading conditions or income flows. Individuals paying provisional tax want a fairer deal that allows them to pay tax in proportion to their earnings for a quarter after the end of that quarter. They are concerned about the arbitrariness of the provisional tax 'uplift factor', and see their competitors who use companies enjoying a cash flow advantage through paying their tax much later.

As a whole, the current design of the tax system requires a small/medium manufacturing employer (for example) to make, in the space of twelve months, at least 12 payments of tax instalments on behalf of employees, 4 income tax payments, 12 sales tax payments and, perhaps, 4 fringe benefits tax payments. That's 32 separate interactions with the Tax Office, plus income tax and Fringe Benefits returns, as well as other obligations (for example, lodging Group Certificates).

The inflexible nature of our tax payment systems was also highlighted in the Bell Report.

Our withholding systems are inefficient and outdated

The most effective, simple and convenient way for most people to meet their annual tax obligations is to pay by instalments, as their income is earned. This eliminates large end-of-year tax bills and ensures that government has the revenue it needs during the year to provide benefits and services.

However, Australia's core withholding system — the Pay As You Earn (PAYE) system — relies heavily on outmoded ideas of 'master' and 'servant' to define obligations. It simply has not kept pace with labour market trends and is falling further behind. Australia needs a modern, comprehensive withholding system for payments to workers.

The Prescribed Payments System (PPS) and Reportable Payments System (RPS) are essential to maintaining the integrity of the current system, but both add costs to the industries in which they operate.

The tax laws are too complex and advice too uncertain

The present tax laws are contained in a number of separate pieces of legislation. Despite recent simplification efforts, rules, definitions and procedures are not consistent. Taxpayers cannot get a private ruling about some tax issues and Tax Office oral advice is never binding.

The cash economy is growing

The present taxes and collection systems allow too much scope for taxpayers to participate in the cash economy.

The goal

The Government's goal is for a fairer tax system that has the community's confidence, in which:

- business relates to all levels of government easily;
- business' obligations to collect tax on behalf of the Government and to make their own tax payments are made simpler and more uniform across business types;
- tax laws become clearer and taxpayer rights and obligations are more certain; and
- fewer people avoid tax by participating in the cash economy.

The strategy

The Government's strategy is to:

- change the system of business registration to make it possible for business to deal with the whole of government at one place and with one business identifier;
- simplify and standardise business payment and reporting systems;
- improve the design of tax laws to minimise avoidance and maximise certainty; and
- make other changes to administration to make complying with tax obligations simpler and fairer.

The plan

Improving the business registration system

With the introduction of the goods and services tax (GST) the Government will rationalise identification of business across all regulatory bodies, so that GST will not be an additional requirement.

The Government will ensure that each business:

- has only one number to identify it for all government purposes, to be known as the Australian Business Number (ABN);
- can deal with, and obtain information and assistance from all of government through one, or as few as possible, entry points; and
- need notify any changes in their details only once and to only one authority.

To this end, the Tax Office will create and maintain a register of Australian businesses for all Commonwealth purposes. This system will be available to State, Territory and local government regulatory bodies to reduce the multiplicity of government registration and reporting.

At the Commonwealth level, business will only be required to quote one number for their public dealings under the tax and corporations laws. The number will not be their Tax File Number, ensuring that existing privacy safeguards are maintained.

The introduction of the ABN was recommended by the Bell Report as part of measures designed to:

- facilitate the introduction of a single tax compliance statement;

- streamline business interaction with the Commonwealth;
- provide a mechanism for collecting and distributing information through a single entry point; and
- facilitate the development of a single entry point and streamlined registration process.

The new business numbering arrangements will be introduced as soon as possible, and before the GST commences.

By ensuring that all bona fide businesses are registered and that withholding arrangements cover all payments by businesses to people who are not in an identified business, this system will enable the Tax Office to make significant inroads into the cash economy.

Introducing one tax instalment system for all taxpayers

The Government will replace five existing payment and reporting systems (PAYE, PPS, RPS, provisional tax and company instalments) with one new, comprehensive pay as you go (PAYG) system.

The new PAYG arrangements are designed to achieve several aims:

- to get business taxpayers, both individuals and companies, paying their income tax at the same time
  - — currently companies have favorable treatment, paying their tax after the year of income, while individuals must pay all instalments within the income year;
- to allow provisional taxpayers with fluctuating incomes to make payments more closely aligned to their income receipts and trading conditions;
- to make it possible for business to make one net payment, or to claim one net refund, quarterly
  - — quarterly obligations will be due on 21 October, January, April and July;
- to abolish provisional tax and the uplift factor;
- to give business certainty about which payments to workers are subject to withholding;
- to respond, in conjunction with the introduction of the ABN, to recommendations of the Bell Report;
- to improve compliance and impact on the cash economy by facilitating cross-matching between GST and income tax information.

PAYG will be a flexible system. Taxpayer obligations will be transparent and easily managed as a by-product of other business activities. In this way, paying income tax and collecting other taxes will become simpler and less costly.

Under PAYG:

- businesses will pay quarterly instalments (based on income actually received) after the end of a quarter or, in some cases, annually;
- employees and similar workers will have tax withheld from the payments they receive; and
- everyone will be able to make additional payments as it suits them.

Quarterly income tax instalments

PAYG will replace both the provisional tax and company instalments systems. Businesses that register for the GST (whether company, sole trader or other) will pay their income tax in four quarterly instalments, at the time they remit their GST payments (or claim their GST refunds). They will be able to offset credits of GST against instalments of income tax or other payments (such as remittances of withholding tax instalments) that are made at that time.

A single quarterly payment will be made on the 21st day of the month following the end of the quarterly period. The payment relating to July, August and September will be paid on 21 October. Other quarterly payments will be due on 21 January, 21 April and 21 July.

Quarter	Payment date
July-September	21 October
October-December	21 January
January-March	21 April
April-June	21 July

Non-GST payers, who currently pay quarterly provisional tax will make quarterly PAYG payments. They will, as a general rule, remit amounts based on income actually derived in the quarter. Some non-GST payers will have the choice of remitting instalments based on last year's income, without an uplift factor.

Some very small businesses that are not involved in GST may elect to pay one annual instalment during the year. From the 2002-03 financial year, the date of this payment for both individuals and companies will become 21 October, following the end of the financial year.

For larger businesses, the timing of GST, company tax and withholding will not be fully aligned. GST returns for large business will be required each month, while their instalments of income tax will remain quarterly.

Withholding remittances will also stay on the same pattern as at present, as large businesses can manage these obligations independently and they often handle the various tax obligations in separate parts of their organisation.

Calculating instalments on turnover

The advent of the GST will provide a way for businesses to calculate an instalment of income tax payable each quarter, without using last year's income and without having to apply an uplift factor.

Under this system, businesses registered for GST will use their quarterly GST sales figure and the ratio of tax payable to sales from the most recent year, to calculate the amount of their income tax instalment for that quarter.

For example, a business with total sales of $1 million in a year, a taxable income of $100,000 and tax payable of $36,000, would pay only 3.6 per cent of the quarterly GST sales figure as their quarterly income tax instalment.

If a business's circumstances change significantly so that the ratio of tax to sales for the most recent year is not the best means of calculating their liability, they may vary the instalment amount, as they do now.

Where a business incurs significant one off or non-recurring expenditure such as research and development costs, the normal tax ratio will probably be too high, so that the business will vary the amount of its income tax payment. Businesses will therefore have the option to vary their payments to ensure that tax payments are properly related to profits generated during the year.

Whom will this affect?

Individuals who pay provisional tax will benefit from these changes, significantly in many cases. Companies will have to pay tax earlier, but the impact of the earlier payments will be more than offset by GST cash flow benefits for all but larger companies.

Individuals and companies who presently pay income tax annually and who will not pay GST instalments will be able to choose whether to pay income tax annually or quarterly and whether to base their payments on last year's income tax paid.

Table 4.1: Simpler payment arrangements under PAYG

Ref	Business type	Size (tax payable)	Old payment schedule	New payment schedule
A	**Individual (small tax)**	<$8,000 and in GST	Annual payment from 1 April	**Quarterly Payments** 21 October 21 January 21 April 21 July
B	**Individual (small tax)**	<$8,000 and not in GST	Annual payment from 1 April	
C	**Individual (other)**	>$8,000	Quarterly payments 1 September 1 December 1 March 1 June	
D	**Company (small tax)**	<$8,000 and in GST	Annual payment 15 December	
E	**Company (small tax)**	<$8,000 and not in GST	Annual payment 15 December	
F	**Company (medium tax)**	$8,000 — $300,000	Quarterly payments 1 June 1 September 1 December 1 March	
G	**Company (large tax)**	>$300,000	Quarterly payments 1 March 1 June 1 September 1 December	

These individuals and company taxpayers have the choice whether to pay quarterly or remain annual payers. From 2003, their annual payment date will be aligned to 21 October.

Current annual provisional taxpayers

Individuals who pay less than $8,000 tax per year on business and investment income currently pay provisional tax in a lump sum, in April or May each year, before all of the income for that year has been earned.

In 1995-96, 1.4 million individuals paid $5 billion in lump sum annual provisional tax instalments.

A: For individuals (small tax) who are GST payers, PAYG means . . .

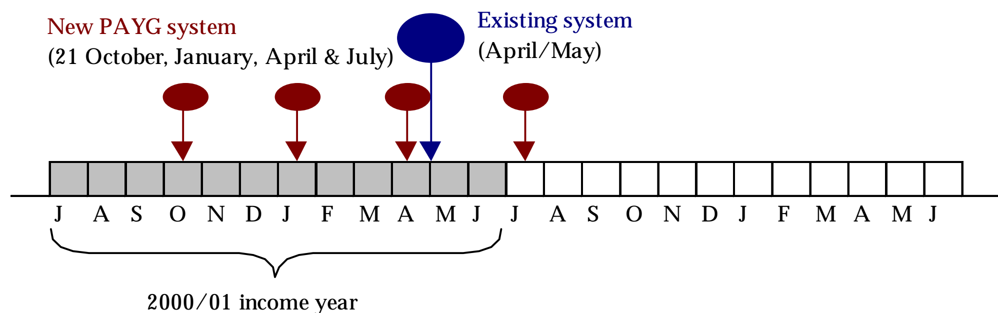
They will pay income tax instalments quarterly after income is earned, at the same time that they make their GST payments. For income earned in July, August and September, payment will be due on 21 October. For income earned in April, May and June, the payment will be due in the following income year on 21 July.

In the first year of PAYG these businesses will pay less income tax than they do now. For example, instead of paying a lump sum in April/May of $8,000 a business would pay four instalments totaling $8,000 in October, January, April and July. Only three of these instalments will be made within the year.

The instalments will be based on the actual income earned, better reflecting trading conditions and income flows. This will mean that taxpayers will pay less when they earn less and more when they are in a better earnings position and have more funds available. These individuals will no longer have to pay provisional tax.

Individuals in GST
(Annual income tax <$8,000)

Payments move from April/May
to October, January, April and July



B: For individuals (small tax) who are not GST payers, PAYG means . . .

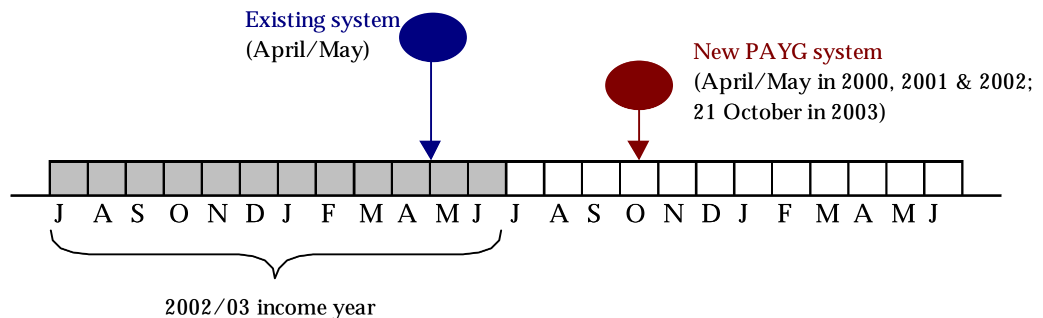
Small tax individuals not in the GST system can choose whether to pay quarterly or annually. If they choose to remain an annual payer they may, in some cases, also choose to base their payment on last year's income, without applying an uplift factor.

From 2003 the time for annual payments will move out from April/May 2003 to 21 October 2003, so that their payment date is aligned with that of similar sized companies. Effectively these taxpayers will pay 6 months later than they do now. These individuals will no longer have to pay provisional tax.

In 2002-03 these taxpayers will not have to make an income tax payment at all.

Individuals who choose to pay annually
(Not in GST and annual income tax <$8,000)

Payments move from April/May to October in 2003



Quarterly provisional taxpayers

Individuals who pay more than $8,000 tax per year on business and investment income currently pay quarterly provisional tax. In 1995-96, 136,000 individuals paid $3.2 billion in quarterly provisional tax instalments.

Quarterly provisional tax is paid on 1 September, 1 December, 1 April and 1 June, before all of the income for the quarter has been earned.

C: For other individuals, PAYG means . . .

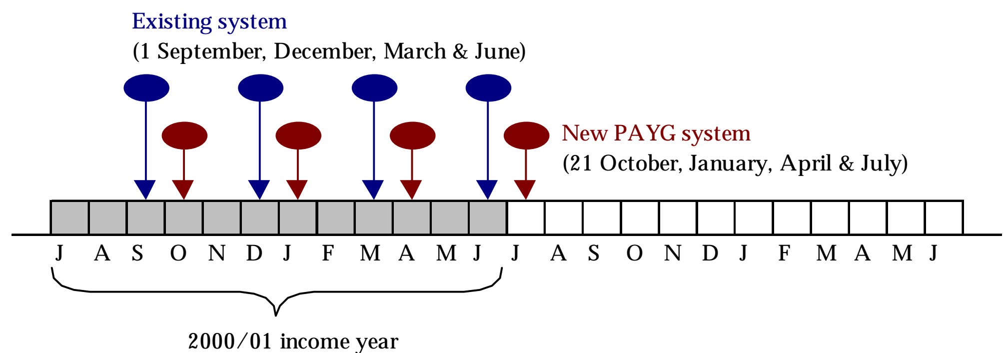
Paying their tax 50 days later every quarter — on the 21st of the month after the quarter, instead of the 1st of the last month in the quarter. These individuals will no longer have to pay provisional tax.

In the first year of PAYG these taxpayers will pay less tax than they do now. For example, a taxpayer paying $100,000 income tax per year currently pays four instalments of $25,000 all within the year. Under PAYG the last instalment is not due until after the income year in July.

The payments will be based on the actual income earned and, in this way, will better reflect trading conditions and income flows. This will mean that these taxpayers will pay less when they earn less and more when they have more funds available.

Current quarterly provisional taxpayers
(Annual income tax >$8,000)

Payments move from September, December, March and June
to October, January, April and July



Annual company taxpayers

Companies that pay less than $8,000 tax per year are currently required to pay their income tax in one lump sum six months after the income year. If the income year ends on 30 June, the lump sum payment is due on 15 December. In 1995-96 there were 433,000 companies, paying annual instalments of around $290 million.

D: For small tax companies in the GST system, PAYG means . . .

They will pay quarterly after their income is earned, at the same time they make their GST payments. For example, assuming an income year ending 30 June, for income earned in July, August and September, payment will be due on 21 October.

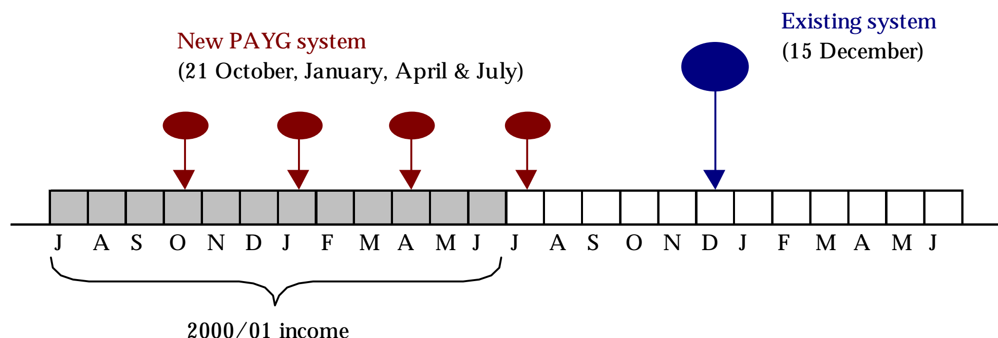
The instalments will be based on the actual income earned in the most recent quarter, better reflecting trading conditions and income flows. This will mean that taxpayers will pay less when they earn less and more when they have more funds available.

Transitional measure: Under the new system payments will be made 9 months earlier, on average. To counter this the Government will defer one full year's tax, due under the existing system on 15 December 2000, so that it is paid in interest free instalments over 5 years. This means that the changed arrangements are effectively phased in over 5 years.

As a consequence, these taxpayers will actually pay less income tax in the first year of PAYG. For example, a company that pays $8,000 tax on 15 December, will instead pay three smaller instalments in October, January and April and the fourth instalment after the end of the income year in July.

Small tax companies in the GST system
(Annual income tax < $8,000)

Payment moves from December
to October, January, April and July



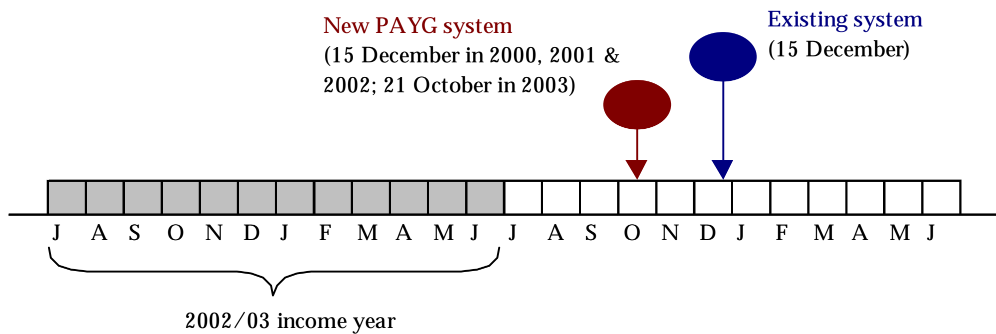
E: For small tax companies not in the GST system , PAYG means . . .

They can choose whether to pay quarterly or annually.

From 2003 the time for their annual payment moves forward 54 days. For the income year ending 30 June their annual payment will move from 15 December 2003 to 21 October 2003. This will align annual payments made by companies and individuals.

Small tax companies not in GST that choose to pay annually
(Annual income tax < $8,000)

Payments move from December to October in 2003



Companies that pay 4 instalments

Medium tax companies pay between $8,000 and $300,000 tax per year in four instalments. Only the first payment falls within the income year. In 1995-96, these companies numbered 92,000 and paid $3.9 billion of tax.

F: For medium tax companies, PAYG means . . .

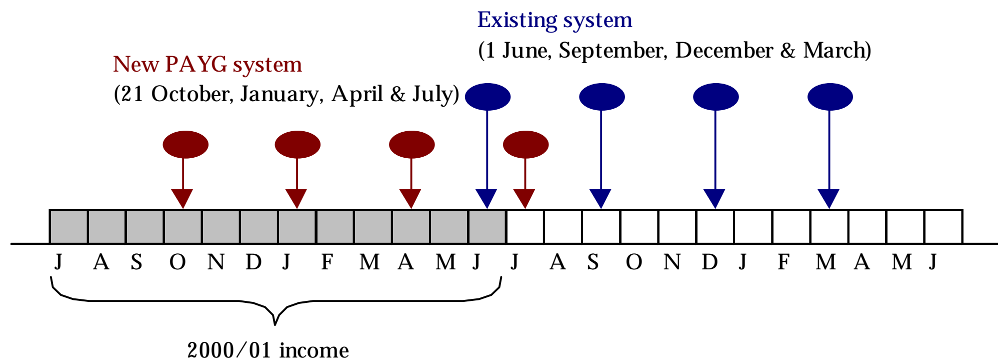
They will pay quarterly after income is earned, at the same time they make their GST payments. For example, for an income year ending 30 June, the instalment for income earned in July, August and September, will be due on 21 October.

Instalments made by these companies will be based on the actual income earned, better reflecting trading conditions and income flows. This will mean that they will pay less when they earn less and more when they have more funds available.

Transitional measure: Under the new system payments will be made 8 months earlier and, if nothing was done, these companies would have to pay tax for the current year and the previous year at the same time. To prevent transition to the new system from having serious cash flow effects, the Government will defer the third and fourth instalments, and part of any outstanding balance, for the 1999-00 income year so that it is payable in interest free instalments over 5 subsequent years.

Medium tax companies
(Annual income tax between $8,000 and $300,000)

Payments move from June, September, December and March
to October, January, April and July



Large tax companies are those that pay more than $300,000 annually. Their income tax is paid in four instalments with the first two, March and June (assuming an income year ended 30 June), falling within the income year. In 1995-96, these companies numbered around 5,000 and paid $12.2 billion in tax.

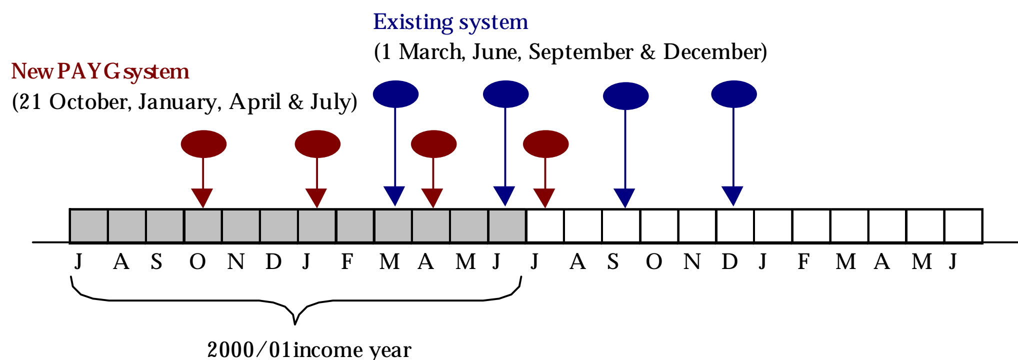
G: For large tax companies, PAYG means . . .

They will pay quarterly after income is earned, at the same time they make their GST payments. For example, for income earned in July, August and September payment will be due on 21 October, assuming an income year ending 30 June. The instalments will be based on the actual income earned better reflecting trading conditions and income flows.

Transitional measure: Under the new system payments will be made 5 months earlier. For these companies one instalment will still be due under the existing payment system after the first payment is made under PAYG. To prevent them having to pay tax for the current year and the previous year at the same time, the Government will defer the fourth instalment (not including any outstanding balance) for the 1999-00 income year, so that it is payable in interest free instalments over 2½ years.

Large tax companies
(Annual income tax >$300,000)

Payments move from March, June, September and December
to October, January, April and July



Withholding arrangements

A second arm of PAYG will provide more certainty about which payments made by businesses for work are subject to withholding.

Withholding arrangements will apply to payments to employees and other office holders (covered by the existing PAYE system) and, in addition, a payer will withhold:

- from *specified payments*, such as labour hire arrangements;
- from a payment for work if the payee agrees to instalment deductions being made (*voluntary agreements*); and
- from a payment on an invoice that does not include quotation of an ABN.

The new withholding system will present an opportunity for the Tax Office to modernise the declaration and reconciliation arrangements that apply to the PAYE system (eg employment declaration forms, issuing of Group Certificates, etc).

Specified payments

The Government has been approached by a number of industries and their workers seeking a means to make source deductions while avoiding the 'employer' and 'employee' labels that go with the existing PAYE system. To facilitate this in the future, the Government will introduce a mechanism whereby payments can be specified as subject to withholding. Only one category of payment will be specified initially:

- a payment to a worker from a labour hire firm, for work performed for a client of the labour hire firm.

Importantly, this approach will allow the tax instalment collection system to adapt to changes in our evolving economic circumstances. New categories will be able to be added by regulation, but this will only occur after appropriate consultation.

Voluntary agreements

The new system will have added flexibility to meet the needs of individual businesses. In cases where a business and its workers are not otherwise covered by withholding, it will be possible for them to elect to participate in the withholding system.

Withholding where no ABN is quoted

The introduction of the ABN will provide an important opportunity to improve compliance. Businesses will generally be required to issue an invoice quoting their ABN. In most cases this will happen as a part of the normal GST arrangements for tax invoices. However, a person will not be able to quote an ABN if they are not carrying on a business (as the Tax Office will not issue them one). Therefore, if a business receives an invoice for work or services rendered, that does not quote an ABN, they will be required to withhold from the payment (just as they do for payments to their other workers).

This approach will do away with the need for difficult judgements by businesses about whether the service providers they engage are employees or contractors.

It will also have a significant impact on the cash economy.

Reporting arrangements

The Government will abolish the PPS and RPS reporting systems. The proposed ABN will provide a basis for a simple reporting system if tax evasion is suspected in a particular industry. The new reporting capability will only be activated if the Government is convinced that it is necessary and then only for a specified period. When it is invoked, a business in an affected industry will only be required to report the information contained in the invoices it already receives.

Alignment of business tax obligations — one return and one payment each quarter

Under the new arrangements, all quarterly payment and remittance dates — including income tax instalment payments, withholding remittances and Fringe Benefits Tax (FBT) payments — will be aligned with the new quarterly GST and PAYG payment dates, ie 21 October, 21 January, 21 April and 21 July. Most businesses will, therefore, be able to complete a single compliance statement once a quarter, and make one quarterly payment. Business will be able to make a net payment after offsetting creditable amounts such as diesel fuel credits (see Chapter 2, and 'Reforming customs administration' below) and GST *input tax credits*.

Excess credits will be refunded and refund claims for any quarter can be lodged on the first day after the quarter. The Tax Office will pay refunds within 14 days of the claim or be liable to pay interest.

From 1 July 1999, a year before the introduction of the new PAYG system, businesses that remit PAYE monthly and quarterly will have an extra fourteen days to make their payments. That is, the remittance dates for monthly and quarterly PAYE will move from the 7th day of the month to the 21st. The date for remittance of PAYE by large employers will not change.

Improving certainty and the reliability of advice

The Government will promote measures that contribute to improved compliance and make:

- tax administration simpler for taxpayers with simple affairs;
- the Tax Office more accountable for its oral advice; and
- taxpayer services more accessible.

Reduced period of review and adjustment

Under existing arrangements, an assessment can be amended by the Tax Office within four years. For taxpayers with simple tax affairs who are doing the right thing, this period is too long. The lack of finality results in uncertainty and the need to keep records for unnecessary periods.

To reduce the uncertainty and the compliance costs for these taxpayers, the Government will limit the amendment period to two years. In practice this will mean that the majority of salary or wage earners will not be subject to further Tax Office scrutiny after this time.

An unlimited period will continue to apply in cases of fraud or evasion.

Binding oral advice

The Government will ensure that taxpayers with simple tax affairs can rely on oral advice received from the Tax Office. Such advice will be binding on the Commissioner in much the same way as written private rulings.

Rulings

The current system of binding rulings has several shortcomings. For example, at present the Commissioner cannot give a ruling on procedural, administrative or collection matters and recent Court decisions have indicated that a ruling cannot be given on a question of fact.

The rulings system will be made comprehensive and its scope more certain.

Charging in special cases

At present, all Tax Office advice is provided free of charge. This includes everything from very simple enquiries, through to extremely complex multi-billion dollar deals. To provide binding advice to taxpayers in complex cases, the Tax Office must commit high level technical resources for extended periods. This represents a significant cost to the community.

The Government will examine a system of user charges for private rulings and other binding advice given to large business taxpayers in complex cases. The user charge will be used to maintain suitably skilled professional resources, able to provide timely, quality advice.

Better access and modern delivery

The Government will improve community access to the services of the Tax Office and other agencies.

The Tax Office will enter into arrangements with other government agencies to make services available through networked access points. The 'whole of government' approach will take advantage of electronic service delivery and improve information sharing between relevant government agencies. This will mean a tax system that is more convenient, can be easily understood and is seen to be fair.

Other initiatives will enhance interaction between the Tax Office and taxpayers. These include better taxpayer enquiry services and the use of modern electronic service delivery technologies.

Promoting electronic connections

The Tax Office will continue to look at ways to promote greater use of electronic connections for the tax obligations of business. This will reduce compliance costs (including GST costs) and help to get Australian business online.

Simplifying tax returns

One way of simplifying the tax system and eliminating the need for some people to lodge tax returns would be to abolish the categories of income tax deductions for employees that are known as *work related expenses*. The money saved by abolishing those claims would then be put into either a standard deduction or rebate, or even into further tax rate cuts, and wage earners' tax returns would be made simpler.

The Government has considered this approach, but concluded that, while the idea of simplifying the income tax return process further is compelling, each of these approaches has problems. For example, the abolition of work related expense deductions would either leave a significant number of taxpayers disadvantaged, or be too expensive to deliver. Furthermore, denial of any of these deductions would add complexity to the FBT system.

However, the Government is still interested in simplifying the tax obligations of wage earners and has therefore asked the Taxation Task Force to undertake further work on proposals to simplify and rationalise deduction and rebate claims, or find alternative ways to deliver those benefits. These proposals will be brought forward in the normal course.

One option that the Tax Office will explore is replacing the existing taxpayer prepared annual return with a Tax Office generated income statement. The statement would contain the income details that have been reported through the new withholding and other systems. Taxpayers could simply confirm the information by telephone to receive their refund, or add details of any other income and claims for rebates or deductions as appropriate. Conceptually a statement approach would apply to 3½ million taxpayers whose income is derived from wages and salaries, dividends and interest investments and who have the more straight-forward rebates and deductions. The Tax Office will consult with a view to piloting these statements for the income year 2000-01.

A second approach that the Tax Office will explore is the idea of providing a choice about whether to lodge a tax return for people with small balances. For around one million people each year, the result of lodging their tax return is either less than $100 to pay or less than $100 refunded. Almost half of these people incur return preparation costs and many are receiving only salary or wages, or a social security benefit. The Tax Office will also consult with a view to establishing the viability of optional tax returns for these classes of people.

Establishing an integrated tax code

The tax laws will be brought together in a code that supports a more cohesive approach to compliance and administration. Both the tax code and the tax system will:

- be designed from the taxpayers' perspective;
- integrate all the tax rules, using consistent terminology and definitions;
- use general principles in preference to long and detailed provisions;
- be sustainable, easily understood and difficult to avoid; and
- be developed over time to better link with related laws such as social security and customs and excise.

Subsume the Tax Law Improvement Project

The Tax Law Improvement Project, with the assistance of the Consultative Committee and private sector representatives, has developed considerable experience in writing laws so that they can be more easily understood. The Government will be giving further consideration as to how to best make use of this expertise in developing the new integrated tax code. Accordingly, the resources of that Project will be made available to assist in the implementation of the Government's tax reform package.

Reducing tax avoidance and the cash economy

Tax avoidance

The Government will modernise the general anti-avoidance rules (Part IVA of the *Income Tax Assessment Act 1936*) to ensure that they deal with existing and emerging risks. They will be broadened to include avoidance schemes involving the use of rebates, credits and losses.

A review of specific anti-avoidance provisions will also be undertaken to identify those that can be consolidated and harmonised in line with the principles of the integrated tax code. Redundant provisions will be removed.

The cash economy

The whole package of tax reform will enhance community confidence in the fairness of the tax system. The combined effect of the various measures will be greater fairness, transparency and certainty, resulting in increased compliance. Some specific measures will assist the Tax Office to make greater in-roads into the cash economy. The GST, the alignment of business tax payments, the establishment of the ABN and the new withholding arrangements will, together, result in more timely receipt of better information and a more comprehensive matching capability for the Tax Office to act upon. The level of integration of the GST into the tax system as a whole will be a key feature of the Government's approach.

The introduction of the ABN will make it much more difficult for those operating in the cash economy to avoid their tax responsibilities. It will also put a stop to people opting out of employment relationships to avoid withholding taxes and thereby slipping into the cash economy.

Those within the community who continue to flout our tax laws and place an unfair burden upon others, will no longer get away with it. More scrutiny will also be given to the tax-driven activities of high wealth individuals, tax manoeuvring of international groups and artificial end-of-year tax planning. A special focus will be given to activities aimed at exploiting any of the new measures foreshadowed in this package.

The Commissioner of Taxation has estimated that $3.5 billion over three years in additional income tax revenue will be generated as a result of these collective impacts.

Why are there no specific measures to counter erosion of the PAYE base?

There is growing pressure on the PAYE tax base.

One response would be to deem wider classes of persons as employees and bring them into the PAYE tax base. But this could affect legitimate contractors.

This package will relieve some of the worst aspects of the problem, without the need to adopt approaches that would adversely impact on genuine contractors. This will occur as:

- the pressures to move out of the PAYE system will not exist to the same extent under the Government's new, generic tax instalment deduction system;
- the scope of the withholding arm of the new generic system will be more certain than the existing PAYE system;
- under the GST, service providing companies will be more visible to the Tax Office and so opportunities to escape the income tax net will be fewer; and
- the advantage that companies have enjoyed over unincorporated contractors, because company tax is remitted much later than provisional tax, is eliminated by the new comprehensive income tax payment arrangements.

Reforming customs administration

The replacement of the Diesel Fuel Rebate Scheme and the creation of the Government's innovative diesel fuel credit, delivered through the GST, provide an opportunity to remove duplication in paperwork and reporting. Claiming a diesel fuel credit should not be an additional burden on business.

The fuel substitution legislation, which came into effect on 31 January 1998, will be reassessed in light of the new diesel fuel credit arrangements.

Existing Customs concessions, rebates, remissions and regulations will be rationalised to deliver the intended results in a simpler, less costly and consistent manner, while ensuring that compliance is maintained. Consultation with industry will be an important element of this process.

Revenue measures table: administration*

Administration measures		1999-00 ($bn)	2000-01 ($bn)	2001-02 ($bn)	2002-03 ($bn)
Company payment arrangements		0.21	2.35	2.60	2.42
Abolition of provisional tax (a)		0.00	-1.44	0.00	-0.92
	Total	0.21	0.92	2.60	1.51
Enhanced compliance		0.00	0.80	1.43	1.35
GST policy/administration costs		-0.35	-0.35	-0.30	-0.29
National fiscal impact		**-0.14**	**1.37**	**3.73**	**2.57**

* A positive revenue or outlays number implies a positive impact on the budget balance.

(a) Revenue impact of moving provisional tax payers onto the new pay as you go system.

Benefits
The impact of the Government's reforms

Overview

The tax reform package will bring significant benefits to individuals and families. It will also enhance economic growth and job creation, and completely transform Commonwealth-State financial relations. The reform will be accomplished within the confines of the Government's medium-term fiscal strategy.

The tables that follow summarise the economic effects of reform. In addition, they present cameos illustrating the impact of the reform package on many different household types. All of the cameos show that the personal income tax cuts and the increases in social security and family benefits exceed the impact of indirect tax reform on the cost of living, based on the expected increase in the population-wide Consumer Price Index (CPI).

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Benefits for the economy

The fiscal impact

The tax reform package has been designed to be consistent with the Government's medium-term fiscal strategy.

The package will be implemented progressively from 1999-00 and will reduce the size of the Commonwealth surplus projected for that year and subsequent years. The package has a significant fiscal cost (somewhat less than one per cent of GDP annually) but will bring substantial benefits to the operation of the economy and to the sustainability of both Commonwealth and State government finances. Reflecting the considerable improvements in Government fiscal policy in recent years, the tax package can be accommodated while retaining sizeable Budget surpluses as required by the fiscal strategy.

The budgetary position of the States will, over time, be enhanced considerably by the package. In 2000-01, however, the States are projected to have insufficient goods and services (GST) revenue to cover the budgetary cost of all of the other elements of the package, reflecting transitional costs and short-term timing effects. However, the package allows for the Commonwealth's commitment that the States will be no worse off in budgetary terms during the three-year transitional period (to 2002-03) — after which the States will be in a much stronger position, reflecting that GST revenue will grow at an appreciably stronger rate than the Commonwealth grants and State taxes that it is replacing.

In costing the package, the Commonwealth's three-year transitional commitment is assumed to be met by Commonwealth grants in 2001-02 and 2002-03 together with a short-term interest free advance in 2000-01, repayable in the following year.

The broad economic impact

The tax reform package will deliver substantial long-term improvements in the operation of the economy, to the benefit of all Australians.

These improvements will be reflected in higher economic **growth** as a result of stronger, more productive, investment which, together with the lowering of industry costs, will yield better export outcomes. Such changes will be crucial in relaxing the balance of payments constraint that has for so long held back Australia's growth performance. The

combination of higher growth and improved work incentives will deliver more jobs and lower unemployment.

Key elements of the package that will drive higher growth are:

- lower effective income tax rates, lifting incentives to work and save;
- lower, less distorted, industry input costs lifting export profitability and performance;
- abolition of distorting indirect taxes;
- a reformed business tax system, lifting capital productivity;
- lower tax compliance costs, freeing highly skilled resources for more productive endeavour; and
- more secure government finances, removing the need for ad hocery in tax design.

While difficult to measure, these economic growth benefits will be substantial, as shown by a range of independent studies under various assumptions and for somewhat different packages. For example, a 1998 report prepared by the Melbourne Institute of Applied Economic and Social Research in partnership with the Brotherhood of St Laurence and the Committee for Economic Development in Australia (titled Tax Reform: Equity and Efficiency) finds that indirect tax reform alone can increase GDP by about 3¾ per cent in the long run. Another 1998 study by Salamon Smith Barney Stockbrokers found that indirect tax reform could increase GDP by about 2 per cent in the long run. These findings are consistent with the range of results reported in a 1988 OECD study (OECD, 1988, *Tax Reform in OECD countries: Motives, Constraints and Practice*, in OECD Economic Studies No. 10, Spring 1988).

In the short-term, the package might be expected to have **transitional effects** upon both demand (particularly its pattern) and prices.

The pattern of **demand** in the economy is likely to change in the period immediately preceding and following the introduction of the tax reform package. To the extent that consumption decisions are discretionary, some expenditure is likely to increase before implementation of a GST as consumers bring forward consumption in anticipation of higher prices. Other expenditure will be deferred. In contrast, investors may defer expenditure in the expectation of lower prices for investment goods and business may run down their stocks. While the pattern of demand may change in the transition phase, the overall effects on economic activity during this period are likely to be small and dominated by the fiscal stimulus inherent in the package.

Overall, **prices** in the economy are likely to be broadly unchanged following the introduction of the reform package. This overall effect would reflect a small one-off rise in the overall prices of consumption goods and services, offset by a fall in the prices of investment goods. These **relative price** changes — and those within consumption expenditures — must be allowed to occur to bring about the more

efficient allocation of resources flowing from the more neutral (less distorting) indirect tax system. Similarly, some small relative wage effects may occur.

But policies will need to be set to ensure that there are no on-going inflationary effects, as would occur were there to be demands for generalised wage increases. There is, of course, no case for such increases as wage earners will be more than fully compensated for consumption price increases by income tax cuts and increases in government benefits — their real take home pay will actually rise.

Hence policies will need to be set to accommodate some or all (depending on the circumstances at the time) of the small one-off increase in consumer prices but not to permit further flow through. This should be achieved readily in a continuing low inflation environment and given the enhanced credibility of monetary policy that has flowed from the Government's ensuring Reserve Bank independence.

Against this background, and the improved cost structures inherent in the package, the introduction of a GST is unlikely to lead to an increase in inflationary expectations and on-going inflation. This assessment is supported by international experience.[1]

The impact on industry costs and consumer prices

Table 5.1 presents, for a number of broad industry categories, the estimated impact of the indirect tax package on costs of production and final consumer prices. A more detailed table is provided at the end of this chapter.

The impact is to reduce industry costs by an average of 3.2 per cent.

1 Tait, Allan A, (1991) VAT: *Administrative and Policy Issues*, IMF Occasional Paper No 88.

Table 5.1: Impact of tax reform on industry costs and consumer prices (costs in 2000-01 values)

Industry category	Impact on industry costs		Impact on consumer prices
	(%)	($m)	(%)
Agriculture	-2.8	-1,140	6.5
Mining	-4.4	-2,970	na
Food	-3.4	-1,910	4.4
Beverages	-3.0	-350	3.1
Tobacco	-3.6	-60	13.3
Textiles, clothing and footwear	-3.1	-750	5.9
Wood, paper, chemicals and construction products	-3.8	-6,620	0.8
Motor vehicles	-3.7	-1,150	-8.3
Other transport equipment	-3.2	-320	na
Other equipment and manufacturing	-3.4	-2,480	-1.8
Electricity, gas and water	-4.1	-970	5.2
Construction	-4.7	-3,740	na
Wholesale and retail trade	-3.1	-3,510	na
Mechanical and other repairs	-6.2	-1,330	3.6
Accommodation, cafes and restaurants	-2.8	-830	6.7
Transport and storage	-4.8	-3,270	1.6
Communications	-4.9	-1,300	4.7
Finance, property and business services	-3.2	-4,990	-1.9
Ownership of dwellings	2.3	1,620	2.3
Public administration and defence	-2.1	-1,310	7.9
Community services	-1.4	-1,430	-1.3
Cultural, recreational and personal services	-3.6	-1,720	2.5
All industry average	**-3.2**		**2.2***

* The price impacts relate to the private final consumption expenditure deflators. This compares with a CPI effect of 1.9 per cent.

Some industries benefit from larger cost reductions than others. The costs facing the road transport industry, for example, fall substantially (by some 6.7 per cent) due to the removal of wholesale sales tax and the diesel excise reforms.

Even in the banking and financial services sector, which is largely input taxed under the GST, costs are expected to fall. What this means is that there are sufficient wholesale sales tax, excise and other taxes embedded in the costs of banking and financial services that applying a 10 per cent GST to a large share of their inputs will actually cost them less. For this

sector, it is estimated that the cost of intermediate (materials) purchases will fall by about $700 million a year (2000-01 values). The annualised cost of investment goods used in the industry is expected to fall by some $900 million a year. Other tax reductions, including stamp duties, will reduce costs by an additional $600 million a year while the GST will add about $600 million a year to industry costs. In sum, the costs facing the banking and financial services industries are expected to fall by some $1.6 billion a year despite this sector being input taxed under the GST.

The prices of most items purchased by consumers are expected to rise as a result of the indirect tax reforms contained in the package. However, some prices will fall. For example, the prices paid by consumers for things like motor vehicles, electrical equipment, health services and pharmaceutical products should be lowered by tax reform. The 2.3 per cent increase in price of the commodity produced by the 'ownership of dwellings' industry (ie rents) arises from the GST applying to new houses, renovations and additions, repairs and other costs involved in home ownership. But this impact will be dampened by the new First Home Owners' Scheme, which more than compensates for the increase in the prices of new houses (up to $150,000) and has the effect of reducing the overall price increase for housing services from 2.3 per cent to 0.7 per cent. The latter figure is used in the modelling of the distributional impacts of the reform package. The impact on tobacco prices is ignored in that modelling (see below).

Table 5.2 reports the 'deflators' (ie change in average prices) for each category of final demand (other than 'stocks'). The cost of supplying exports is found to fall by nearly 3.5 per cent, or about $4.5 billion in 2000-01 values. And the cost of private investment is found to fall by nearly 7 per cent.

Table 5.2:
Impact of tax reform on the cost of final demand

Category of final demand	(%)
Private final consumption expenditure	2.2
Government final consumption expenditure	-2.0
Private investment	-6.9
Government business enterprise investment	-4.5
General government investment	-4.5
Exports	-3.5

The impact of tax reform on the cost of government purchases is significant. Overall, it is estimated that the costs of government will be reduced by more than $1 billion a year.

An explanation of the modelling approach

Treasury's Price Revenue Incidence Simulation Model (PRISMOD)

Impacts on industry costs, consumer prices and the revenue implications of indirect tax reform have been obtained from Treasury's PRISMOD. This is a large scale, highly disaggregated model of the Australian economy. It contains a very highly detailed specification of the Australian National Accounts (ANA), incorporating all of the detail of inter-industry flows captured in the input-output tables produced by the Australian Bureau of Statistics.

PRISMOD models 107 industries purchasing about 1,200 inputs and selling their product to other industries and seven categories of final demand: private final consumption expenditure (households); government final consumption expenditure (governments); private investment (private businesses); government business enterprise investment; general government investment; stocks and exports (non residents). Indirect taxes are specified at this level of detail.

Price changes are estimated for each of the 107 industry outputs. The estimated price changes for the 107 industries can be used to calculate the price impact on private final consumption expenditure. However, many people are interested in changes in the official CPI, not changes in the price of private final consumption expenditure. The 107 industry outputs are quite different to the 108 expenditure classes used to calculate the official CPI. However, the 107 industries can be mapped across to the 108 CPI expenditure classes to allow a calculation of the change in CPI. When the mapping is done it turns out that the estimated CPI impact of the tax reform package (excluding its impact on tobacco) is very close to its impact on the ANA concept of private final consumption expenditure (but including the impact on tobacco prices).

Key features of the model

In technical jargon, PRISMOD is a *price input-output model.* This means that it focuses on the inter-industry transmission of price changes. For example, it tracks how a change in price of diesel fuel impacts on all industries that purchase diesel, and on all industries that purchase from those industries, and on all purchasers of those industries and so on.

PRISMOD ignores quantity (output) changes — only price impacts are modelled. That is, businesses are assumed to continue to operate with exactly the same inputs, and produce exactly the same outputs, before and after the change being simulated.

Another important feature of the modelling is that all cost and price impacts are passed on fully to final purchasers (eg governments and households). For example, it is assumed that the abolition of the wholesale sales tax would be passed through fully to consumers in the form of lower prices. Similarly, it is assumed that lower transport costs

due to cheaper diesel for road and rail transport are passed through in lower prices for consumers. And it is assumed that the GST is passed through in the form of higher prices for consumers. On the other hand, it is considered very unlikely that exporters would receive lower world prices for their products simply because their costs fall as a result of tax reform. Instead, the assumption is that lower costs for exporters will be reflected in a moderately stronger exchange rate over time. These *incidence* assumptions are standard in this sort of modelling.

PRISMOD says nothing about the timing of price change. All of the price impacts calculated by the model are 'long run' in nature. The experience of other countries is that most of the price impacts of major indirect tax reform flow through within the first twelve months.

Benefits for households

An explanation of the cameo approach

The cameos draw together the effect of the various measures in the reform package to provide details of the overall impact on individuals and families at the point of implementation.

The cameos that follow show, for different household types and different levels of private income, the personal income tax cuts and the increases in family benefits and social security payments that such households will receive. Private income is the income that households receive from non-government sources, before income tax is taken out. It includes income from employment, interest, dividends, rental property income and so on. Disposable income is calculated by subtracting income tax from private income and then adding government cash payments (pensions and benefits, including family payments). The cameos assume that private income is unaffected by the tax reform package. But disposable income is affected because of personal income tax cuts and increases in government cash payments. These measures ensure that disposable incomes increase at all levels of private income.

From the increases in disposable incomes, the increases in the cost of living associated with the net effect of indirect tax reform are then deducted to calculate the extra 'cash in hand' that each household will have.

In all cases the cameos assume that individuals and families who satisfy the income test criteria for family and social security assistance also meet all other relevant eligibility and residence requirements and, hence, receive that assistance. They are based on the projected values of family and social security assistance in July 2000 under the pre-tax reform arrangements, compared to the projected July 2000 values after the tax reform package.

How was the increase in cost of living calculated?

Using population-wide cost of living

The increase in the cost of living associated with the introduction of the tax reform package is calculated using the estimated population-wide CPI increase of 1.9 per cent in 2001-02. This figure has been used to adjust the cost of living of each household group. This is consistent with the longstanding arrangements which adjust the value of social security payments for inflation, based on movement in the population-wide CPI. It needs to be noted, however, that the 1.9 per cent CPI increase excludes the impact of the tax package on tobacco prices. This reflects the Government's view that the impact of the GST on tobacco prices should not, for public health reasons, be offset by income tax cuts and/or increases in social security payments. The 1.9 per cent CPI takes account of the new First Home Owners' Scheme's offsetting the impact of the GST on new house prices.

Alternative methodologies are flawed

The population-wide CPI describes an average impact across different households. Some researchers will want to use different cost of living measures for different household groups. However, disaggregating the population-wide CPI among different households is not desirable. Those researchers who have attempted to do so in the past have used Australian Bureau of Statistics (ABS) data from the Household Expenditure Survey (HES). Certain features of the HES invalidate its being used in this way.

This is because of the adjustments made by the ABS in order to calculate weights for the CPI — these adjustments assure a better CPI but, without them, the HES data contain biases. For example, adjustments are made for known cases of under reporting (eg tobacco and alcohol) and some expenditure estimates (eg some consumer durable items) are subject to high sampling errors and are adjusted using other data on expenditure levels.

The HES is conducted over a full year to take account of seasonal variations in expenditure. Household expenditure for each household is based on two weekly personal diaries and, to minimise sampling error, on information provided on a recall basis for periods up to two years on items purchased infrequently, such as household appliances and motor vehicle registration and insurance. It is not appropriate to draw statistical inferences from individual household records in the survey. It is only through the aggregation process that seasonal and other irregular variations in expenditure patterns are ironed out.

Some researchers modify the raw HES unit record data set by discarding 'outliers'. This practice is actually more likely to reduce the quality of the HES data. The reason is that this will lead to a downward

bias in the expenditure estimates for those variables that have produced the 'outliers'. Furthermore, it will have an affect on other expenditure variables as the 'outliers' typically come from households with large expenditures.

The issue of different cost of living measures for different household groups has been examined in detail by the ABS. They concluded, in the publication *Feasibility of Constructing Price Indexes for Special Population Groups* (Catalogue No. 6445.0) that there was almost *no difference* in the overall price increase each household group faced over a period of eleven years — despite prices rising by 120 per cent over that period.

For these reasons, governments have consistently adopted the practice of providing compensation for price increases by adjusting benefits by the movement in the population-wide CPI.

Disposable income is the better measure

The increase in the population-wide CPI is applied to household disposable income rather than to household consumption in calculating the increase in the cost of living. The cost of living estimate is therefore a measure of the change in value of real disposable income. This technique has the effect of ignoring differences in saving ratios among households. This is consistent with the approach of many researchers who take the view that current consumption (in a particular week, month, or even year) provides a less reliable measure than disposable income of a household's ability to consume. And it is a household's ability to consume that is really of interest, since that is what is affected by cost of living changes.

There is a more pragmatic reason for basing the cameo calculations on disposable income, rather than current consumption. While there is a National Accounts measure of average household saving, there are no reliable data on the saving rates of different types of households. For example, the HES, which has sometimes been used for such purposes, does not contain reliable data of this sort — a point that the ABS emphasises with each survey release.

However, some comment can be made on the significance of the approach for the data in the cameos. Those who would prefer to see cost of living calculations based on current consumption will presumably want to argue that, to the extent households spend less than their total income (ie save), the cost of living increases reported here will be overstated and, hence, the cash gains are understated. They will also take the view that, to the extent households spend more than their income (ie dissave), the cost of living increases will be understated. Making such adjustments, however, would have an imperceptible effect on the cameos — especially as the population-wide household saving rate is about 5 per cent.

Calculating the benefits for pensioners

As noted in Chapter 1, in July 2000 pensioners and beneficiaries will receive an up-front payment increase of 4 per cent. Table 5.3 shows the projected value of the age pension in July 2000, before and after the up-front adjustment.

Table 5.3:
July 2000 adjustments to age pensions

Single pensioners	**$/fortnight**
Projected pension before 4% adjustment	384.50
Projected pension after 4% adjustment	400.00
Pension increase	15.50
Pensioner couples	**$/fortnight**
Projected pension before 4% adjustment	642.00
Projected pension after 4% adjustment	667.50
Pension increase	25.50

In addition to the up-front 4 per cent increase in pensions and benefits, the Government will ensure that over time the increase is maintained at 1½ percentage points above the actual impact of the tax reform package on the CPI. The effect of the 1½ per cent real increase is illustrated in the cameos for pensioners and beneficiaries.

What isn't covered in the cameos?

There are a number of factors not covered in the cameos. Most importantly, they do not cover the efficiency and macroeconomic benefits to Australia from tax reform.

The Government's package of reforms creates a tax system to take Australia into the twenty-first century. Tax reform is being undertaken to make the economy work better; so as to promote higher economic growth and higher living standards (see studies referred to earlier in this chapter) — not to redistribute the tax burden. But gains from higher growth are not easy to measure. Additional gains will accrue to the economy, under this package, through more effective taxing of the 'cash economy'.

It is not possible to calculate the distribution of these gains to particular types of households. As a result, the cameos do not attempt to capture, for example, the benefit to a family which now decides that it is worth getting a job, rather than relying on government assistance, or the benefits from the increased employment opportunities and income associated with the shift of investment from artificial tax minimisation

schemes into genuinely productive enterprises such as construction or tourism.

In addition, the cameos do not capture the impact of measures designed to crackdown on loopholes and make people pay their fair share. These include: greater taxation compliance arising from the GST and more effective income tax administration; and changes to Fringe Benefits Tax, including the reporting of fringe benefits over $1,000 on employee Group Certificates. They also do not include the effect of the childcare reforms, the benefits of the new private health insurance initiative, or the introduction of refundable imputation credits.

The benefits estimated

The 107 industries presented in the tables that follow correspond to those used in the *Australian National Accounts, Input-Output Tables* (ABS Catalogue No. 5209.0). Industries 01.01 to 04.00 represent agriculture; 11.00 to 15.00 are the mining industries; 21.01 to 37.01 are the manufacturing industries; 41.01 and 41.02 are the construction industries; and 45.01 to 96.01 are the services industries.

Not all of the 107 industries supply product directly to household consumers. For example, none of the mining industries do so, and very little of the output of the agricultural industries is consumed by households in the form in which it leaves the agricultural producer. Similarly, households do not directly consume the output of the 'residential building construction' industry (41.01). Instead, these industries supply their product to other industries that in turn supply goods and services to households.

For example, sheep are sold largely to the 'meat and meat products' industry (21.01). In the process, transport and other costs of distribution are added. The 'meat and meat products' industry sells to retailers who then sell to consumers. Again, transport and other costs of distribution are added along the way. PRISMOD captures all of these costs.

A further illustration is provided by the 'water, sewerage and drainage' industry (37.01). Its output is purchased as an intermediate (materials) input to most other industries. About half of its output is purchased by the 'ownership of dwellings' industry (77.01). The price paid by households for water, sewerage and drainage services is therefore reflected in the cost of the product supplied by the 'ownership of dwellings' industry. So too is most of the household consumption of paints (25.03). 'Ownership of dwellings' is the industry that supplies housing services to renters and owner-occupiers. The output of the 'ownership of dwellings' industry is a flow of services consumed by these two groups. In the Australian National Accounts, this is how the housing costs of consumers are represented. As noted earlier, the

effective increase in price of this industry's output is reduced from 2.3 per cent to 0.7 per cent once account is taken of the First Home Owners' Scheme.

Most of the 107 industries produce a large number of different products consumed by households. For example, the ‘fabricated metal products’ industry (27.05) produces things like cutlery, metal hand tools for gardening, nails, screws, metal blinds and awnings, firearms and television antennae. Because different products will typically face different WST treatment (and may even face different treatment under the GST), it is difficult to predict from the tables the precise impact of tax reform on the prices of individual products. This means that considerable caution should be exercised in using the tables.

For example, the price of products produced by the ‘dairy products’ industry (21.02) is estimated to increase by 3.3 per cent. But this is really an average of price changes for a large group of different products including things like ice cream (which is expected to fall in price) and plain milk (which is expected to increase in price). Similarly, the price of the ‘other services’ industry (96.01) is estimated to go up by 4.4 per cent. This industry includes religious services. But it would clearly be wrong to conclude that the price of religious services will go up by that amount since religious services will be *GST-free*. A better indicator of the likely price change for religious services is given by the reduction in costs facing the ‘other services’ industry (ie a reduction of 2.1 per cent).

The price impacts of reform are presented in their original form as well as on a weighted basis to indicate the contribution each industry makes to the aggregate price impact on private final consumption expenditure of 2.2 per cent (only marginally different from the estimated CPI impact of 1.9 per cent).

Cost effects (by industry) of indirect tax reform

	Industry	$ million	Per cent change
01.01	Sheep	-100	-2.6%
01.02	Grains	-200	-3.2%
01.03	Beef cattle	-160	-2.8%
01.04	Dairy cattle	-100	-2.7%
01.05	Pigs	-30	-3.2%
01.06	Poultry	-60	-3.3%
01.07	Other agriculture	-230	-2.3%
02.00	Services to agriculture; hunting and trapping	-80	-2.7%
03.00	Forestry and logging	-40	-2.0%
04.00	Commercial fishing	-110	-3.6%
11.00	Coal, oil and gas	-1260	-4.7%
13.01	Iron ores	-260	-5.8%
13.02	Non-ferrous metal ores	-1020	-3.9%
14.00	Other mining	-220	-5.3%
15.00	Services to mining nec	-170	-3.1%
21.01	Meat and meat products	-500	-3.1%
21.02	Dairy products	-310	-3.4%
21.03	Fruit, vegetable products	-220	-4.0%
21.04	Oils and fats	-50	-3.3%
21.05	Flour mill products and cereal foods	-140	-3.5%
21.06	Bakery products	-180	-3.5%
21.07	Confectionery	-80	-3.4%
21.08	Other food products	-390	-3.4%
21.09	Soft drinks, cordials and syrups	-170	-3.8%
21.10	Beer and malt	-120	-3.6%
21.11	Wine and spirits	-40	-1.2%
21.12	Tobacco products	-50	-3.6%
22.01	Textile fibres, yarns and woven fabrics	-230	-3.2%
22.02	Textile products	-110	-3.3%
22.03	Knitting mill products	-70	-3.3%
22.04	Clothing	-220	-2.9%
22.05	Footwear	-50	-2.9%
22.06	Leather and leather products	-60	-3.2%
23.01	Saw logs and dressed timber	-120	-3.1%
23.02	Other wood products	-170	-3.0%
23.03	Pulp, paper and paperboard	-200	-3.8%
23.04	Paper containers and products	-160	-4.0%
24.01	Printing and services to printing	-310	-3.5%
24.02	Publishing; recorded media and publishing	-370	-3.5%

Cost effects (by industry) of indirect tax reform (continued)

	Industry	$ million	Per cent change
25.01	Petroleum and coal products	-1120	-4.3%
25.02	Basic chemicals	-510	-3.8%
25.03	Paints	-70	-3.6%
25.04	Medicinal and pharmaceutical products; pesticides	-280	-3.4%
25.05	Soap and detergents	-60	-3.6%
25.06	Cosmetics and toiletry preparations	-50	-3.6%
25.07	Other chemical products	-110	-3.5%
25.08	Rubber products	-120	-3.4%
25.09	Plastic products	-340	-3.4%
26.01	Glass and glass products	-80	-3.8%
26.02	Ceramic products	-110	-4.0%
26.03	Cement, lime and concrete slurry	-190	-5.2%
26.04	Plaster and other concrete products	-130	-4.3%
26.05	Other non-metallic mineral products	-60	-3.9%
27.01	Iron and steel	-660	-4.1%
27.02	Basic non-ferrous metal and products	-640	-4.3%
27.03	Structural metal products	-260	-3.6%
27.04	Sheet metal products	-90	-2.7%
27.05	Fabricated metal products	-300	-3.2%
28.01	Motor vehicles and parts; other transport equipment	-1130	-3.7%
28.02	Ships and boats	-90	-3.3%
28.03	Railway equipment	-50	-3.3%
28.04	Aircraft	-170	-3.2%
28.05	Photographic and scientific equipment	-230	-3.5%
28.06	Electronic equipment	-750	-3.6%
28.07	Household appliances	-160	-3.3%
28.08	Other electrical equipment	-290	-3.3%
28.09	Agricultural, mining and construction machinery	-310	-3.3%
28.10	Other machinery and equipment	-360	-3.2%
29.01	Prefabricated buildings	-30	-3.8%
29.02	Furniture	-190	-3.0%
29.03	Other manufacturing	-110	-3.3%
36.01	Electricity supply	-460	-3.1%
36.02	Gas supply	-120	-5.6%
37.01	Water supply; sewerage and drainage services	-380	-5.7%
41.01	Residential building construction	-1660	-4.9%
41.02	Other construction	-2070	-4.6%
45.01	Wholesale trade	-1880	-3.3%

Cost effects (by industry) of indirect tax reform (continued)

	Industry	$ million	Per cent change
51.01	Retail trade	-1650	-2.9%
54.01	Mechanical repairs	-800	-5.7%
54.02	Other repairs	-520	-7.2%
57.01	Accommodation, cafes and restaurants	-820	-2.8%
61.01	Road transport	-1500	-6.7%
62.01	Railway, pipeline and other transport	-320	-3.8%
63.01	Water transport	-390	-5.7%
64.01	Air and space transport	-630	-4.0%
66.01	Services to transport; storage	-510	-3.2%
71.01	Communication services	-1310	-4.9%
73.01	Banking	-670	-2.8%
73.02	Non-bank finance	-80	-1.2%
73.03	Financial asset investors	-100	-4.2%
74.01	Insurance	-40	-0.3%
75.01	Services to finance, investment and insurance	-710	-7.9%
77.01	Ownership of dwellings	1620	2.3%
77.02	Other property services	-830	-3.2%
78.01	Scientific research, technical and computer services	-900	-3.6%
78.02	Legal, accounting, marketing and business management services	-1200	-3.3%
78.03	Other business services	-390	-3.3%
81.01	Government administration	-900	-1.9%
82.01	Defence	-340	-2.8%
84.01	Education	-240	-0.7%
86.01	Health services	-820	-1.7%
87.01	Community services	-280	-2.7%
91.01	Motion pictures, radio and television services	-290	-4.5%
92.01	Libraries, museums and the arts	-80	-1.9%
93.01	Sport, gambling and recreational services	-480	-3.9%
95.01	Personal services	-540	-5.9%
96.01	Other services	-330	-2.1%
	Industry average		**-3.2%**

Note on housing costs

The estimated 2.3 per cent increase in the cost of the output of the ownership of dwellings industry is due to the GST treatment of new houses. The First Home Owners' Scheme more than compensates for the increase in the price of new houses (up to $150,000 excluding land) and reduces the overall effective price increase experienced by consumers of housing services (renters and owner-occupiers) from 2.3 per cent to 0.7 per cent.

Price effects (by industry) of indirect tax reform

	Industry	Per cent	Weighted
01.01	Sheep	na	na
01.02	Grains	na	na
01.03	Beef cattle	na	na
01.04	Dairy cattle	na	na
01.05	Pigs	na	na
01.06	Poultry	na	na
01.07	Other agriculture	6.7%	0.13
02.00	Services to agriculture; hunting and trapping	na	na
03.00	Forestry and logging	na	na
04.00	Commercial fishing	6.0%	0.04
11.00	Coal, oil and gas	na	na
13.01	Iron ores	na	na
13.02	Non-ferrous metal ores	na	na
14.00	Other mining	na	na
15.00	Services to mining nec	na	na
21.01	Meat and meat products	6.6%	0.19
21.02	Dairy products	3.3%	0.06
21.03	Fruit, vegetable products	5.7%	0.09
21.04	Oils and fats	6.3%	0.02
21.05	Flour mill products and cereal foods	6.2%	0.04
21.06	Bakery products	4.3%	0.08
21.07	Confectionery	1.7%	0.01
21.08	Other food products	2.1%	0.06
21.09	Soft drinks, cordials and syrups	3.3%	0.04
21.10	Beer and malt	3.3%	0.08
21.11	Wine and spirits	2.7%	0.05
21.12	Tobacco products	13.3%	0.27
22.01	Textile fibres, yarns and woven fabrics	6.1%	0.02
22.02	Textile products	3.5%	0.02
22.03	Knitting mill products	6.6%	0.03
22.04	Clothing	6.8%	0.21
22.05	Footwear	6.8%	0.05
22.06	Leather and leather products	-0.9%	0.00
23.01	Saw logs and dressed timber	na	na
23.02	Other wood products	na	na
23.03	Pulp, paper and paperboard	na	na
23.04	Paper containers and products	-3.0%	-0.01
24.01	Printing and services to printing	1.1%	0.01
24.02	Publishing; recorded media and publishing	4.0%	0.08

Price effects (by industry) of indirect tax reform (continued)

	Industry	Per cent	Weighted
25.01	Petroleum and coal products	0.0%	0.00
25.02	Basic chemicals	na	na
25.03	Paints	na	na
25.04	Medicinal and pharmaceutical products; pesticides	-2.8%	-0.05
25.05	Soap and detergents	-1.5%	-0.01
25.06	Cosmetics and toiletry preparations	1.8%	0.01
25.07	Other chemical products	0.6%	0.00
25.08	Rubber products	0.2%	0.00
25.09	Plastic products	0.9%	0.00
26.01	Glass and glass products	5.7%	0.01
26.02	Ceramic products	3.8%	0.01
26.03	Cement, lime and concrete slurry	na	na
26.04	Plaster and other concrete products	na	na
26.05	Other non-metallic mineral products	na	na
27.01	Iron and steel	na	na
27.02	Basic non-ferrous metal and products	na	na
27.03	Structural metal products	na	na
27.04	Sheet metal products	na	na
27.05	Fabricated metal products	3.9%	0.01
28.01	Motor vehicles and parts; other transport equipment	-8.3%	-0.21
28.02	Ships and boats	na	na
28.03	Railway equipment	na	na
28.04	Aircraft	na	na
28.05	Photographic and scientific equipment	-2.1%	-0.02
28.06	Electronic equipment	-5.5%	-0.07
28.07	Household appliances	0.1%	0.00
28.08	Other electrical equipment	0.1%	0.00
28.09	Agricultural, mining and construction machinery	-3.8%	-0.01
28.10	Other machinery and equipment	na	na
29.01	Prefabricated buildings	na	na
29.02	Furniture	-0.5%	-0.01
29.03	Other manufacturing	-0.7%	-0.01
36.01	Electricity supply	6.6%	0.10
36.02	Gas supply	3.9%	0.02
37.01	Water supply; sewerage and drainage services	na	na
41.01	Residential building construction	na	na
41.02	Other construction	na	na
45.01	Wholesale trade	na	na

Price effects (by industry) of indirect tax reform (continued)

	Industry	Per cent	Weighted
51.01	Retail trade	na	na
54.01	Mechanical repairs	3.8%	0.09
54.02	Other repairs	2.5%	0.01
57.01	Accommodation, cafes and restaurants	6.7%	0.29
61.01	Road transport	2.6%	0.02
62.01	Railway, pipeline and other transport	5.8%	0.03
63.01	Water transport	na	na
64.01	Air and space transport	-0.8%	-0.01
66.01	Services to transport; storage	na	na
71.01	Communication services	4.7%	0.03
73.01	Banking	-10.6%	-0.16
73.02	Non-bank finance	-6.1%	-0.02
73.03	Financial asset investors	na	na
74.01	Insurance	0.8%	0.01
75.01	Services to finance, investment and insurance	-1.0%	0.00
77.01	Ownership of dwellings	2.3%	0.42
77.02	Other property services	6.7%	0.01
78.01	Scientific research, technical and computer services	na	na
78.02	Legal, accounting, marketing and business management services	6.4%	0.04
78.03	Other business services	6.4%	0.02
81.01	Government administration	7.9%	0.02
82.01	Defence	na	na
84.01	Education	-0.3%	-0.01
86.01	Health services	-1.3%	-0.08
87.01	Community services	-2.7%	-0.04
91.01	Motion pictures, radio and television services	5.0%	0.01
92.01	Libraries, museums and the arts	7.7%	0.03
93.01	Sport, gambling and recreational services	0.9%	0.03
95.01	Personal services	3.6%	0.06
96.01	Other services	4.4%	0.03
	Industry total		**2.21**

Note on housing costs

The estimated 2.3 per cent increase in the cost of the output of the ownership of dwellings industry is due to the GST treatment of new houses. The First Home Owners' Scheme more than compensates for the increase in the price of new houses (up to $150,000 excluding land) and reduces the overall effective price increase experienced by consumers of housing services (renters and owner-occupiers) from 2.3 per cent to 0.7 per cent.

The cameos — at a glance

The cameo tables at the end of this chapter provide a detailed estimate of the impact of the new tax system on household types. All of the cameos show that the personal income tax cuts and the increases in social security and family benefits exceed the impact of indirect tax reform on the cost of living, based on the estimated increase in the population-wide CPI.

The tax reform package restores equity to the tax system. The new income tax scale concentrates tax cuts on middle income earners. Those with incomes between $38,000 and $50,000 will find their marginal tax rate cut by 13 percentage points, from 43 per cent to only 30 per cent. Some 81 per cent of taxpayers will face a marginal tax rate of 30 per cent or lower. Lower income earners are also major beneficiaries of the increase in the tax free threshold and the cut in the lower marginal rates from 20 per cent to 17 per cent and from 34 per cent to 30 per cent. The gains to higher income earners are capped by the maintenance of the 47 per cent top marginal rate. This means that a person with an income of $200,000 (or even $1,000,000) receives the same tax cut (the same dollars per week) as a person with an income of $75,000.

The large increases in family benefits are also concentrated on middle income families. Middle income families gain the most from the tax reform package. In fact, the cameos understate the true gains for families beyond July 2000. This is because they do not allow for the impact of the normal annual indexation arrangements for family assistance. These will increase family assistance over time by the amount of the increase in the CPI due to tax reform. That is, the discrete increases in family assistance illustrated in the cameos in July 2000 will actually be established as ongoing real increases.

The following provides a brief explanation of the factors underpinning some of the cameo results.

Single person

At low levels of private income, people gain from the real increase in social security payments, as such people would be eligible for Newstart Allowance.

Between the private income levels of $14,800 and $20,700 the gain in disposable income drops (but remains positive) because of the combined effect of:

- the social security income test applying over a longer range of income than occurs under the current system (due to the increased adequacy of allowances); and

- the second lowest statutory marginal tax rate applying to an individual's income slightly earlier than occurs under the current system.

The significant increases in disposable income that occur thereafter are due to the lower marginal tax rates. The gains are maximised (in percentage terms) at $75,000, due to the unchanged marginal rate of 47 per cent applying from that income level.

Dual income couple with no dependent children

At low levels of income these families benefit from the real increase in social security payments and the reduction in the first marginal tax rate to 17 per cent.

Between private family income levels of around $27,000 and $30,000 the gain in disposable income falls (but remains positive). The larger benefit at income levels below this range is due to the social security income test applying over a longer range of income than occurs under the current system due to the increased adequacy of allowances.

For couples with equally shared incomes, the significant increase in the net cash gain between the private family income levels of $76,000 and $80,000 arises from the second marginal tax rate (now 30 per cent) applying to an individual's income for a longer range of income than occurs under the current system (ie up to $50,000 a year for each individual, rather than $38,000).

Single income couples with dependent children

Families in this situation receive significant increases in disposable income, due to the combined effect of the tax cuts and families package.

The significant increases in disposable income that occur between the private family income levels of $17,000 and $35,000 (higher where there is more than one child) arise from the income tax cuts, the substantial easing of the income test for family assistance (which is designed to improve work incentives) and the increased levels of assistance for families. The gains are greatest where there is a child aged under 5 years in the family, due to the $350 a year extra increase in assistance for such families.

The increases in disposable income between the private family income levels of $69,000 and $83,000 (higher if there is more than one child in the family) arise from the income tax cuts and the relaxation of the income tests for the various family assistance measures within the current system.

Sole parents

Sole parents receive significant increases in disposable income at all income levels.

At low levels of income, they benefit from increases in social security payments and a large boost in family assistance.

The significant increases in disposable income between the private family income levels of $19,000 and $35,000 (for one child) arise from the income tax cuts, the substantial easing of the income test for family assistance (which improves work incentives) and the increased level of assistance for families.

The increases in disposable income between the private family income levels of $69,000 and $83,000 (for one child) arise from the income tax cuts and the relaxation of the income tests for the various family assistance measures within the current system.

Dual income couples with dependent children

These families gain from the new tax system at all levels of combined family income, due to the combined effect of the tax cuts and the families package.

The significant increases in disposable income between the private family income levels of $27,000 and $35,000 (for one child) arise from the income tax cuts, the substantial easing of the income test for family assistance (which is designed to improve work incentives) and the increased levels of assistance for families.

The increases in disposable income between the private family income levels of $69,000 and $83,000 (for one child) arise from the income tax cuts and the relaxation of the income tests for the various family assistance measures within the current system.

Age pensioners

The significant increase in disposable income that occurs for pensioners over most of the income range is due to the increased adequacy of pensions and the more generous pension rebate and pension income test.

There is a fall-off in (but still positive) net cash gain between the private income levels of $23,000 and $28,600 ($38,000 and $48,000 for couple pensioners). This is because the relaxed pension income test results in some people becoming newly eligible for a part-rate pension at income levels within these ranges. The amount of pension these people receive reduces as their income increases, thereby reducing the increase in disposable income.

Self-funded retirees

At low levels of private income (ie less than $13,000 a year for single people and $21,000 for couples) self-funded retirees do not pay tax under the current or new systems. However, they gain from the Aged Persons Savings Bonus (which is assumed to generate an investment income of 5 per cent) and from the Self-Funded Retirees Supplementary Bonus of $200 a year for ten years (paid as a lump sum of $2,000).

Beyond $13,000 (or $21,000), self-funded retirees gain from the tax cuts, including the increase in the tax rebate for low income aged people. Some also gain from the increase in the cut-out point for the age pension that results from the relaxation of the pension income test. In addition, lower income self-funded retirees who own shares gain from the introduction of refundable franking credits and many self-funded retirees benefit from the new private health insurance initiative, with some offset due to the removal of the savings rebate — these effects are not included in the cameos.

The Cameos

Individuals	single person
Sole parents	one dependent child aged under 5 years
	two dependent children one aged under 5 years
Single income family	no dependent children
	one dependent child aged under 5 years
	one dependent child aged between 5 and 13 years
	two dependent children one aged under 5 years
	two dependent children aged between 5 and 13 years
	three dependent children, one aged under 5 years
Dual income family (income split 50:50)	no dependent children
	one dependent child aged under 5 years
	one dependent child aged between 5 and 13 years
	two dependent children one aged under 5 years
	two dependent children aged between 5 and 13 years
	three dependent children, one aged under 5 years
Dual income family (income split 67:33)	no dependent children
	one dependent child aged under 5 years
	one dependent child aged between 5 and 13 years
	two dependent children one aged under 5 years
	two dependent children aged between 5 and 13 years
	three dependent children, one aged under 5 years
Aged Australians	single age pensioner
	age pensioner couple
	single self-funded retiree
	self-funded retiree couple (50:50)