Greenwoods & Freehills

Tax Brief

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The Henry Review's First Paper – Watch This Space

The proposal for a 'root and branch' review of Australia's tax system first emerged from the Prime Minister's '2020 Summit' in April, and was then re-announced in the May Budget. The committee selected by the Treasurer to undertake this review, now called Australia's Future Tax System Review ('**the Review**'), released its first paper yesterday. The paper is a weighty work – it is well over 300 pages – and so this Tax Brief examines its main focus and broad thrust.

The title of the paper, *Architecture of Australia's Tax and Transfer System*, shows its principal focus – it is concerned with the operation of the personal income tax, taxes on consumption, various State taxes and the social security system, alone and in combination. Corporate tax is discussed for its impact on individual savings behaviour. The paper concentrates on issues affecting households and individuals which was always expected judging from the initial terms of reference and statements from Ken Henry quoted in the press that the Review would focus on how to make the welfare and tax systems fairer.

As the first paper from the Review, it is largely descriptive of the current state of the tax system at state and federal level, and of the operation of the social welfare system. It does occasionally offer analysis – examining what the circumstances being described mean, as well as what they are – but for substantive recommendations, we must wait for the ensuing papers.

For business, therefore, it was not likely that this paper would hold many surprises. The parts that are relevant to business deliver a few key messages:

- Australia imposes many taxes (the paper identifies 125), but just a few generate almost all of the tax revenue – 10 taxes raised 90% of total tax revenue;
- the number of taxes, and the differences between the same tax in different States, add significantly to the complexity of the system and its drag on the economy;
- Australia has an unusually high reliance on taxes on income from capital, especially corporate tax, compared to taxes on income from labour, wealth or consumption taxes;
- our headline corporate tax rate is now above the OECD average (which has dropped to 26.6%); only 7 years ago, our corporate rate was below the OECD average (32.5% in 2001). Australia is also one of the few countries to maintain an imputation system;

- but overall, Australia's total tax burden is low (8th lowest of OECD countries), with a commensurately low level of government expenditure, and the mix of taxes between direct and indirect taxes is not significantly different from those of comparable countries.

The paper does not express a view on whether Australia should conform to, or depart from, the international practices it describes.

The chapter on the taxation of savings and investment comments that the tax system influences the decision whether to save and where to save. It notes,

> *The level and form of tax affects incentives to save (and hence the level of saving), whether investments are made in Australia or overseas, the type of entity used to invest the savings, the financial structure for funding the investments, and the allocation between different types of assets.*

The paper also notes that globalisation means it is becoming increasingly difficult for revenue authorities to tax both the foreign source income of residents and the Australian source income of non-residents.

The next papers will, hopefully, contain some greater inkling about what these observations imply. Is the Review hinting that the corporate rate might be reduced to keep pace with the rate reductions occurring elsewhere, might imputation be in jeopardy, will the taxation of trusts and companies be more closely aligned, will we shift to a dual income tax for mobile forms of income or is the Review re-considering the shift in our international tax policy away from capital export neutrality that occurred only a few years ago as a result of the review of Australia's international tax arrangements?

Business should also note one interesting development in the past few months: the government has adopted the practice of deflecting new tax issues – including business tax issues – to the Review for it to handle. The May Budget announced that the Review would examine the impacts of the emissions trading scheme; in early August, the Prime Minister and the Assistant Treasurer Chris Bowen both announced that the Review would be examining the role of Australia's tax rules in Australia becoming a global financial services centre; in June, the Minister for Small Business Craig Emerson announced that the Review would be examining a proposal for a flow-through tax regime for small business; and when a mild furore arose in June from the announcement in the May Budget that access to various tax offsets and government support programs would now count superannuation and fringe benefits as part of a person's income, the matter was quickly shelved and then referred to the Review. If this practice continues, the previous focus on individuals and households may yet expand to include more attention to business tax issues.

Yesterday the Treasurer claimed that 'the Review will be the most comprehensive examination of the tax system in over 50 years.' It remains to be seen whether the recommendations of the Review will prove more thorough and generate more wide-ranging and longer-lasting outcomes than, say, the Asprey report (1975), the RATS reforms (1985), the ANTS measures (1998) or the Ralph Committee (1999). FBT, CGT, imputation and GST are big headlines to eclipse so, if the Treasurer is serious about the scale of the changes envisaged, best watch this space.

The Review plans to hold consultations in the near future based on 'key focussing questions' to be released later this month. There is already a telephone hotline in operation. The Review is due to deliver its final report to the Government by the end of next year, in time for the 2010 election.

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