Government Tax Changes and the Henry Proposals – the good, the bad and the ugly for SMEs

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Introduction

On 2 May 2010 the Government released the long awaited Henry Tax Review and announced its initial response. Of the 138 Henry reform proposals a few were taken up, some rejected outright and the majority left for future consideration. This paper focuses on the main proposals, both adopted and foreshadowed, that will impact on the SME market. The paper will not deal with the social security and resources tax reforms.

Reforms adopted on May 2

Company and small business tax recommendations

- A company tax rate of 29% from 2013-14 and 28% from 2014-15. For small business, the company tax rate will reduce in a single step to 28% and be implemented from 2012-13.

- Accelerated capital allowances system for small business from 1 July 2012:
  - An immediate write-off of assets valued at less than $5,000 (instead of the $10,000 amount as recommended). Currently, small business taxpayers are able to write-off assets under $1,000, and
  - Allowing small business to write-off all other assets (except buildings) in a single depreciation pool at a rate of 30%. At present, there are two asset pools, namely the long life asset pool and general business pool for SBEs.

Superannuation

- Superannuation Guarantee (SG) charge is to be increased to 12% commencing with a 0.25% increase in 2013-14 and 2014-15, followed by 0.5% increments until the SG reaches 12% by 2019-20. (not a Henry proposal)

- SG age limit to be raised from 1 July 2013 to 75, with the effect that workers aged from 70 to 74 will be eligible to have SG contributions made on their behalf. This matches the age limit for voluntary contributions and contributions by the self-employed.

- New low income earners Government contribution will be introduced from 1 July 2012 of up to $500 annually into the superannuation account of workers on adjusted taxable incomes of up to $37,000 to offset the 15% contributions tax. Thus $3,333 in concessional contributions might be paid tax free. The co-contribution scheme will be retained.

- From 1 July 2012, workers aged 50 and over with superannuation balances below $500,000 will be able to make up to $50,000 in annual concessional superannuation contributions (indexed). This measure extends the transitional contribution cap which was to end on 30 June 2012.

Reforms adopted on May 11

Individuals and families

- From 1 July 2011, individuals will be entitled to a 50% discount on up to $1,000 of interest earned (directly or indirectly). (Henry recommended 40% discount for investment income and expenses including net interest income, net residential rental income, capital gains and losses and interest expenses related to investments in listed shares.)

- From 1 July 2012, individual taxpayers will be entitled to an optional standard deduction of $500, increasing to $1,000 from 1 July 2013.

- The medical expenses tax offset threshold will be increased from $1,500 to $2,000 with effect from 1 July 2010. The threshold will also be indexed annually, with effect from 1 July 2011. (Henry favoured removal of offset.)

Companies and business

- From 1 July 2009, where a private company provides a dwelling (acquired before that date) to the shareholder of the private company or their associate, for use as their main residence, a payment will not arise under the non-commercial loan rules. A continuity of ownership rule will apply. (not a Henry proposal)

- The income tax treatment of qualifying instalment warrants will be amended to provide certainty for investors by treating them as the owner of the underlying asset for income tax purposes, with effect from 1 July 2007. (not a Henry proposal)

- Payments relating to earnout arrangements from 17 October 2007 will not be treated as in relation to separate assets for CGT purposes but rather treated as relating to the underlying business asset – contrary to TR 2007/D10. (not a Henry proposal)

Superannuation

- The co-contribution matching rate will be permanently maintained at 100% and co-contribution thresholds will be non-indexed for the next two income years. (not a Henry proposal)

GST

- The financial supply provisions will be amended to clarify the operation of the legislation and reduce compliance and administrative costs, particularly for many small businesses, with effect from 1 July 2012. (not a Henry proposal)

- The margin scheme provisions will be restructured to clarify and simplify the current provisions, with effect from 1 July 2012. The Government will also make a minor technical amendment to ensure that a valuation can be obtained for the purposes of using the margin scheme for subdivided land. (not a Henry proposal)

Recommendations rejected

- Reducing the CGT discount

- Limiting negative gearing deductions

- Changing the grandfathering provisions for pre-CGT assets

- Removing the benefits of the imputation system

- Including the family home in means testing calculations

- Making changes to the tax system that would be disadvantageous to the not for profit sector

- Abolition of the luxury car tax

- Reducing indexation of the aged pension

- Introduction of a bequests tax

- Introducing a land tax on the family home

- Aligning the preservation age with pension age

- Increase the rate or broaden the base of the GST (not a Henry proposal)

- Remove tax free superannuation payments for the 60 and over (not a Henry proposal)

Key recommendations yet to be considered

Personal taxation

- Increase the tax-free threshold to $25,000 and enable a constant marginal rate for most individuals by reducing the number of marginal rate bands to two: 35% for taxable incomes of $25,001 to $180,000 and 45% for taxable incomes above $180,000.

- Retain the individual as the primary unit of personal taxation but consider optional couple assessment for couples of late retirement age.

- Restrict the availability of subsidies for dependants through the tax system; in particular, replace the various existing dependency tax offsets with a single tax offset in certain circumstances.

- Tax-exempt status for all income support payments and supplementary payments, including government payments of an income support nature such as scholarships.

- Structural tax offsets (the low income, senior Australian, pensioner tax and beneficiary tax offsets) should not be separate components of the tax system but should be incorporated into the personal tax rates scale.

- Streamline, simplify and improve the effectiveness of concessional offsets. The offsets earmarked for review include the various dependency offsets, the zone tax offset, the primary producers' averaging tax offset and the offset for special professionals. The mature age worker, employment termination payment, overseas civilian, entrepreneurs and notional tax offsets should be removed. The education tax refund should be merged into the single family payment.

- A health levy (such as the current Medicare levy) could be applied as a proportion of net tax payable instead of the current proportion of taxable income.

- Remove the medical expenses tax offset and review the Medicare levy surcharge. Any assistance for purchasing private health insurance should be provided as a premium reduction rather than provided through the personal tax system.

- All forms of wages and salaries should be taxable on an equivalent basis and without exemptions. The broad exemption for foreign employment income should be removed.

- Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of the employees rather than their employers. Employers will retain the FBT obligations for any other fringe benefits with a possible de minimis threshold based on the number of employees.

- Simplification of the scope of taxable fringe benefits. The current formula for valuing car fringe benefits should be replaced with a single rate of 20% regardless of the kilometres travelled.

- Review of the fringe benefits tax exemptions and the removal of the exemption for child care facilities on an employer's premises.

- Extension of the Personal Services Income regime to all entities that earn a significant proportion of income from personal services and introduce an arm’s length rule to deductions in respect of payments to associates.

- Introduce a tighter nexus between the deductibility of an expense and the derivation of income.

Capital gains tax

- Exemption threshold for collectibles should be increased and the exemption extended to all personal use assets (not just where the cost base is less than $10,000).

- The active asset 50% reduction and the 15 year exemption concessions should be removed and the lifetime limit of the retirement exemption aligned with the CGT cap for contributions to a superannuation fund. The small-business CGT concessions should be available to taxpayers selling an interest in a company or trust by reference to the turnover test.

- Rewrite of the CGT provisions.

Business taxation

- Possible development of a business level expenditure tax.

- Carry back of revenue losses by companies for one year with the amount of any refund limited to the franking account balance.

- Low value assets costing less than $1000 to be immediately written off and effective lives reviewed.

- The SBE turnover threshold should be increased from $2M to $5M and the $6M net asset threshold reconsidered.

- Consideration of a reduction in the interest withholding tax rate to zero.

- The trust rules to be rewritten.

Other

- Various reforms should be introduced to ensure a smoother interaction between the tax and social security systems including greater alignment of definitions and the development of single client accounts.

- Further development of the pre-filled personal income-tax return initiative.

- Family tax benefits, the child-care benefit and the child-care rebate to be replaced by a single family payment.

- Move from conveyancing duties and stamp duties on commercial and industrial properties to a broader land tax based on per land holdings not on an entity's total holding.