

12. List of recommendations

Consolidated list of recommendations

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Part One — A tax and transfer system for the 21st century

Recommendation 1: Revenue raising should be concentrated on four robust and efficient broad-based taxes:

- personal income, assessed on a more comprehensive basis;
- business income, designed to support economic growth;
- rents on natural resources and land; and
- private consumption.

Additional specific taxes should exist only where they improve social outcomes or market efficiency through better price signals. Such taxes would only be used where they are a better means to achieve the desired outcome than other policy instruments. The rate of tax would be set in accordance with the marginal spillover cost of the activity.

User charging should play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services.

With both specific taxes and user charges, revenue would be a by-product of the tax or charge, not the reason for it.

Other existing taxes should have no place in the future tax system and over time should be abolished.

A — Personal taxation

A1 — Personal Income tax

Recommendation 2: Progressivity in the tax and transfer system should be delivered through the personal income tax rates scale and transfer payments. A high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity.

Recommendation 3: The primary unit in the personal tax system should continue to be the individual, and subsidies for dependants through the tax system should be restricted (see Recommendation 6a). However, there could be a case for optional couple assessment for people of late retirement age.

Recommendation 4: Income support and supplementary payments should be tax-exempt.

- (a) Family assistance should remain exempt from tax because it addresses direct costs associated with children.
- (b) Government payments that are similar in nature to income support, such as scholarships, should be exempt from tax to align their treatment with that of income support.

Recommendation 5: The Medicare levy and structural tax offsets – the low income, senior Australians, pensioner and beneficiary tax offsets – should be removed as separate components of the system and incorporated into the personal income tax rates scale. If a health levy is to be retained, it could be applied as a proportion of the net tax payable by an individual.

Recommendation 6: To remove complexity and ensure government assistance is properly targeted, concessional offsets should be removed, rationalised, or replaced by outlays.

- (a) The existing dependency offsets should be replaced with a single dependant tax offset where one of the following circumstances apply:
 - the dependant is unable to work due to disability or carer responsibilities; or
 - either the taxpayer or dependant has reached Age Pension age.
- (b) The zone tax offset should be reviewed. If it is to be retained, it should be based on contemporary measures of remoteness.
- (c) The mature age worker, employment termination payment, overseas civilian, entrepreneurs', and notional tax offsets should be removed (see Part Two Annex A1). The education tax refund should be replaced as part of the single family payment, but as a back-to-school (lump-sum) amount.
- (d) The overseas forces tax offset should be replaced by adjusting remuneration to maintain net incomes.
- (e) Averaging tax offsets for primary producers, the offset for 'special professionals' and the lump sum payment in arrears tax offset should be retained to minimise the extent to which the timing of such income influences tax liability (see Part Two Annex A1).

Recommendation 7: Consistent with recommendations by the National Health and Hospitals Reform Commission:

- (a) The medical expenses tax offset should be removed following a review of the scope and structure of health safety net arrangements.
- (b) The Medicare levy surcharge and assistance for private health insurance should be reviewed as part of the package of tax and non-tax policies relating to private health insurance. The Medicare levy surcharge lump sum payment in arrears tax offset should be retained if the Medicare levy surcharge is retained (see Annex A1). Assistance, if retained, for private health insurance should be provided exclusively as a direct premium reduction.

Recommendation 8: All forms of wages and salary for Australian resident taxpayers should be taxable on an equivalent basis and without exemptions.

- (a) Private education payments provided in respect of employment or as an incentive to undertake employment and employment-related payments should be assessed as income and taxed at marginal tax rates.
- (b) The broad exemptions for foreign employment income should be removed and such income should be taxed at marginal tax rates.
- (c) Defence and disciplined forces payments should be taxable and direct remuneration increased for affected personnel.

Recommendation 9: Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other fringe benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate (and non-reportable for employees). The scope of fringe benefits that are subject to tax should be simplified.

- (a) Market value should generally be used to value fringe benefits (with an appropriate adjustment for employee contributions).
- (b) The current formula for valuing car fringe benefits should be replaced with a single statutory rate of 20 per cent, regardless of the kilometres travelled.
- (c) All fringe benefit tax (FBT) exemptions should be reviewed to determine their continuing appropriateness. To improve simplicity, consideration should also be given to excluding fringe benefits from tax where the costs of compliance outweigh equity and tax integrity considerations. The broad definition of fringe benefits in the FBT law could be reviewed to exclude essential workplace items such as chairs, stationery and toilets.
- (d) For fringe benefits that are taxed in the hands of employers, a small *de minimis* threshold, below which fringe benefits are exempt from tax, should apply. The threshold could vary depending on the number of employees within an organisation.
- (e) Not-for-profit entities' FBT concessions should be reconfigured (see Part Two Section B3). The FBT exemptions for members of the Defence force should be replaced with direct remuneration increases for affected personnel (see related Recommendation 8c).

Recommendation 10: Consideration should be given to a revised regime to prevent the alienation of personal services income that would extend to all entities earning a significant proportion of their business income from the personal services of their owner-managers, whether in employee-like or non-employee-like cases. This regime may also apply an arm's length rule to deductions arising from payments to associates to ensure deductions reflect the value of services provided.

Recommendation 11: A standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation.

Recommendation 12: There should be a tighter nexus between the deductibility of the expense and its role in producing income.

Recommendation 13: Gift deductibility should be retained, with the deductibility threshold raised from \$2 to \$25.

Recommendation 14: Provide a 40 per cent savings income discount to individuals for non-business related:

- (a) net interest income;
- (b) net residential rental income (including related interest expenses);
- (c) capital gains (and losses); and
- (d) interest expenses related to listed shares held by individuals as non-business investments.

In conjunction with introducing the discount further consideration should be given to how the boundaries between discounted and non-discounted amounts are best drawn to achieve certainty, reduce compliance costs, and prevent labour and other income being converted into discounted income. Further consideration should also be given to addressing existing tax law boundaries related to the treatment of individuals owning shares in order to address uncertainties about when the shares are held on capital account (and subject to capital gains tax) and on revenue account (and taxed as ordinary income).

Recommendation 15: When the 40 per cent savings income discount is introduced a smooth transition should be provided to minimise any disruption that may arise. The transition to a savings income discount for net residential rental income should only be adopted following reforms to the supply of housing (Part Two Section E4 Housing affordability) and reforms to housing assistance (Section F5 Housing assistance).

Recommendation 16: As part of the consideration of alternative company tax income arrangements and dividend imputation (see Recommendations 26 and 37), consideration should be given to extending the discount to other savings income.

Recommendation 17: The capital gains tax regime should be simplified by:

- (a) increasing the exemption threshold for collectables and exempting all personal use assets;
- (b) rationalising and streamlining the current small business capital gains tax concessions by:
 - removing the active asset 50 per cent reduction and 15-year exemption concessions;
 - increasing the lifetime limit of the retirement exemption by permanently aligning it with the capital gains tax cap for contributions to a superannuation fund; and
 - allowing taxpayers who sell a share in a company or an interest in a trust to access the concessions via the turnover test.
- (c) removing current grandfathering provisions relating to assets acquired before the commencement of capital gains tax, with a market value cost base provided for those assets when the exemption is removed, or before the end of previous indexation arrangements. A relatively long lead-time should be provided before these removals take effect; and
- (d) rewriting the capital gains tax legislation using a principles-based approach that better integrates it with the rest of the income tax system.

A2 — Retirement incomes

Recommendation 18: The tax on superannuation contributions in the fund should be abolished. Employer superannuation contributions should be treated as income in the hands of the individual, taxed at marginal personal income tax rates and receive a flat-rate refundable tax offset.

- (a) An offset should be provided for all superannuation contributions up to an annual cap of \$25,000 (indexed). The offset should be set so the majority of taxpayers do not pay more than 15 per cent tax on their contributions. The cap should be doubled for people aged 50 or older.
- (b) An annual cap on total contributions should continue to apply.
- (c) The offset should replace the superannuation co-contribution and superannuation spouse contribution tax offset.
- (d) Compulsory superannuation contributions made by employers should not reduce eligibility for income support or family assistance payments. They should also not form part of the calculation for child support.

Recommendation 19: The rate of tax on superannuation fund earnings should be halved to 7.5 per cent. Superannuation funds should retain their access to imputation credits. The 7.5 per cent tax should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams.

Recommendation 20: The restriction on people aged 75 and over from making contributions should be removed. However, a work test should still apply for people aged 65 and over. There should be no restrictions on people wanting to purchase longevity insurance products from a prudentially regulated entity.

Recommendation 21: The government should support the development of a longevity insurance market within the private sector.

- (a) The government should issue long-term securities, but only where this is consistent with its fiscal obligations, to help product providers manage the investment risk associated with longevity insurance.
- (b) The government should make available the data needed to create and maintain a longevity index that would assist product providers to hedge longevity risk.
- (c) The government should remove the prescriptive rules in the *Superannuation Industry (Supervision) Regulations 1994* relating to income streams that restrict product innovation. This should be done in conjunction with the recommendation to have a uniform tax on earnings on all superannuation assets.

Recommendation 22: The government should consider offering an immediate annuity and deferred annuity product that would allow a person to purchase a lifetime income. This should be subject to a business case that ensures the accurate pricing of the risks being taken on by the government. To limit the government's exposure to longevity risk, it should consider placing limits on how much income a person can purchase from the government.

Recommendation 23: The government should help make people more aware of the retirement income system, and therefore better able to manage their superannuation, by increasing the regularity of superannuation guarantee contributions, making it easier for people to manage their superannuation and providing people with a single point of contact for government agencies.

- (a) Superannuation guarantee contributions should be paid at the same time as wages. This should be introduced over time so businesses can adjust their cash flows. As a first step, larger businesses (that is, businesses required to lodge their business activity statements on a monthly basis) should be required to pay superannuation guarantee contributions at least monthly.
- (b) Employers should report superannuation contributions to their employees when a contribution is made.
- (c) There should be a method of linking superannuation records, such as client identifiers like the tax file number, to make it easier for people to manage their superannuation.
- (d) A superannuation portal where people can interact with government agencies and get information on retirement incomes should be developed. Over time this portal should evolve, subject to suitable safeguards, so that people can manage all their superannuation through one channel.

Recommendation 24: The preservation age for Service Pensioners should remain at 60 as it is already legislated to align with the eligibility age for that pension. An increase in the preservation age should apply to people who currently have a legislatively prescribed retirement age.

A3 — Wealth transfer taxes

Recommendation 25: While no recommendation is made on the possible introduction of a tax on bequests, the Government should promote further study and community discussion of the options.

B — Investment and entity taxation

B1 — Company and other investment taxes

Recommendation 26: The structure of the company income tax system should be retained in its present form, at least in the short to medium term.

A business level expenditure tax could suit Australia in the future and is worthy of further consideration and public debate. It is possible that other economies will move towards such systems over coming years and it could be in Australia's interest to join this trend at an early stage.

Recommendation 27: The company income tax rate should be reduced to 25 per cent over the short to medium term with the timing subject to economic and fiscal circumstances. Improved arrangements for charging for the use of non-renewable resources should be introduced at the same time.

Recommendation 28: The capital allowance arrangements should be enhanced and streamlined to ensure effective rates more closely match rates of economic depreciation, and to reduce administration and compliance costs overall. This should include:

- (a) allowing low-value assets (assets costing less than \$1,000) to be immediately written-off; and
- (b) reviewing the impact of special provisions applying to different investments in agriculture and statutory effective life caps and other concessional write-off provisions.

Recommendation 29: The capital allowance arrangements for small business should be streamlined and simplified, by:

- (a) allowing depreciating assets costing less than \$10,000 to be immediately written-off; and
- (b) allowing all other depreciating assets (except buildings) to be pooled together, with the value of the pool depreciated at a single declining balance rate.

Recommendation 30: The small business entity turnover threshold should be increased from \$2 million to \$5 million, and adjustments to the \$6 million net asset value test should be considered.

Recommendation 31: Companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income, with the amount of any refund limited to a company's franking account balance.

Recommendation 32: If earlier access to tax benefits from exploration expenses (relative to other expenses) is to be provided, it should take the form of a refundable tax offset at the company level for exploration expenses incurred by Australian small listed exploration companies, with the offset set at the company income tax rate.

Recommendation 33: Financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to non-residents.

Recommendation 34: Consideration should be given to negotiating, in future tax treaties or amendments to treaties, a reduction in interest withholding tax to zero so long as there are appropriate safeguards to limit tax avoidance.

Recommendation 35: Taxation arrangements applying to Australian managed funds and related services should be improved to provide greater certainty that conduit income will not be subject to Australian tax.

B2 — The treatment of business entities and their owners

Recommendation 36: The current trust rules should be updated and rewritten to reduce complexity and uncertainty around their application.

Recommendation 37: Dividend imputation should be retained in the short to medium term, but for the longer term, consideration should be given to alternatives as part of a further consideration of company income tax arrangements.

Recommendation 38: A flow-through entity regime for closely held companies and fixed trusts should not be adopted for now, but would merit further consideration if there is a move away from dividend imputation in the long run.

Recommendation 39: While dividend imputation is retained, imputation credits should continue to be provided only for Australian company income tax. Dividend streaming and franking credit trading practices should, in general, continue to be prohibited.

Recommendation 40: If increased integration of the Australian and New Zealand economies is desired, a broad examination of the appropriate degree of harmonisation of business income tax arrangements between Australia and New Zealand should be undertaken.

B3 — Tax concessions for not-for-profit organisations

Recommendation 41: Consistent with the recommendations of previous inquiries, a national charities commission should be established to monitor, regulate and provide advice to all not-for-profit (NFP) organisations (including private ancillary funds). The charities commission should be tasked with streamlining the NFP tax concessions (including the application process for gift deductibility), and modernising and codifying the definition of a charity.

Recommendation 42: Categories of NFP organisations that currently receive income tax or GST concessions should retain these concessions. NFP organisations should be permitted to apply their income tax concessions to their commercial activities.

Recommendation 43: NFP FBT concessions should be reconfigured.

- (a) The capped concessions should be phased out over ten years. In the transition period, the value of the caps would gradually be reduced. Reportable fringe benefits for affected employees (that is, those benefits that are easily valued and attributed) would be exempt from tax up to the relevant cap, and taxed at the employee's marginal tax rate above the cap. The market value of these benefits would be taken into account for transfer payment purposes. Non-reportable fringe benefits would be taxable for NFP employers.
- (b) The FBT concessions should be replaced with direct government funding, to be administered by relevant Australian government portfolio agencies or the charities commission. All NFP organisations eligible for tax concessions should be able to apply to the relevant body for funding for specific projects or for assistance with the costs of recruiting specialist staff.

Recommendation 44: Simple and efficient tax arrangements should be established for clubs with large trading activities in the fields of gaming, catering, entertainment and hospitality. One option is to apply a concessional rate of tax to total net income from these activities above a high threshold. For clubs below the threshold, no tax would be applied to income from these activities.

C — Land and resource taxes

C1 — Charging for non-renewable resources

Recommendation 45: The current resource charging arrangements imposed on non-renewable resources by the Australian and State governments should be replaced by a uniform resource rent tax imposed and administered by the Australian government that:

- (a) is levied at a rate of 40 per cent, with that rate adjusted to offset any future change in the company income tax rate from 25 per cent, to achieve a combined statutory tax rate of 55 per cent;
- (b) applies to non-renewable resource (oil, gas and minerals) projects, except for lower value minerals for which it can be expected to generate no net benefits. Excepted minerals could continue to be subject to existing arrangements if appropriate;
- (c) measures rents as net income less an allowance for corporate capital, with the allowance rate set at the long-term Australian government bond rate;
- (d) requires a rent calculation for projects;
- (e) allows losses to be carried forward with interest or transferred to other commonly owned projects, with the tax value of residual losses refunded when a project is closed; and
- (f) is allowed as a deductible expense in the calculation of income tax, with loss refunds treated as assessable income.

Recommendation 46: The resource rent tax should not provide concessions to encourage exploration or production activity at a faster rate than the commercial rate or in particular geographical areas, and should not allow deductions above acquisition costs to stimulate investment.

Recommendation 47: Existing projects should be transferred into the proposed system with an adjustment, as appropriate, to the starting base for the allowance for corporate capital. The Australian government should set out a time-frame to implement the resource rent tax and provide guidance at the time of announcement on how existing investments and investment in the interim will be treated under the resource rent tax.

Recommendation 48: The Australian and State governments should negotiate an appropriate allocation of the revenues and risks from the resource rent tax.

Recommendation 49: The Australian and State governments should consider using a cash bidding system to allocate exploration permits. For small exploration areas, where there are unlikely to be net benefits from a cash bidding system, a first-come first-served system could be used.

Recommendation 50: The Australian and State governments should abolish fees and stamp duties on the transfer of interests in a resource project except those related to administrative costs.

C2 — Land tax and conveyance stamp duty

Recommendation 51: Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system. Recognising the revenue needs of the States, the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad consumption or land bases. Increasing land tax at the same time as reducing stamp duty has the additional benefit of some offsetting impacts on asset prices.

Recommendation 52: Given the efficiency benefits of a broad land tax, it should be levied on as broad a base as possible. In order to tax more valuable land at higher rates, consideration should be given to levying land tax using an increasing marginal rate schedule, with the lowest rate being zero, with thresholds determined by the per-square-metre value.

Recommendation 53: In the long run, the land tax base should be broadened to eventually include all land. If this occurs, low-value land, such as most agricultural land, would not face a land tax liability where its value per square metre is below the lowest rate threshold.

Recommendation 54: There are a number of incremental reforms that could potentially improve the operation of land tax, including:

- (a) ensuring that land tax applies per land holding, not on an entity's total holding, in order to promote investment in land development;
- (b) eliminating stamp duties on commercial and industrial properties in return for a broad land tax on those properties; and
- (c) investigating various transitional arrangements necessary to achieve a broader land tax.

D — Taxing consumption

Recommendation 55: Over time, a broad-based cash flow tax — applied on a destination basis — could be used to finance the abolition of other taxes, including payroll tax and inefficient State consumption taxes, such as insurance taxes. Such a tax would also provide a sustainable revenue base to finance future spending needs.

D1 — A cash flow tax

No recommendations in this section.

D2 — The goods and services tax

Recommendation 56: The Government should consider making greater use of GST-free business-to-business transactions or reverse charging, provided the potential compliance cost savings outweigh the additional complexity costs and risks to revenue.

D3 — Payroll tax

Recommendation 57: State payroll taxes should eventually be replaced with revenue from more efficient broad-based taxes that capture the value-add of labour.

D4 — Taxing financial services

No recommendations in this section.

E — Enhancing social and market outcomes

E1 — User charging

No recommendations in this section.

E2 — Taxes to improve the environment

Recommendation 58: Once the Carbon Pollution Reduction Scheme (CPRS) is operational, additional measures which seek to reduce emissions (in sectors covered by the CPRS), and which are not justified on other grounds, should be phased out.

Recommendation 59: The industry assistance arrangements introduced in consequence of the CPRS should be regarded as transitional. The Government's policy is to commission an independent review of the CPRS, including in relation to emissions-intensive trade-exposed (EITEs) assistance, every five years starting in 2014. To complement this, the Productivity Commission should be asked to undertake and publish an annual review of CPRS-related assistance arrangements for the life of the CPRS to provide a basis for future decisions on assistance policy. To assist the Productivity Commission, an Associate Commissioner with appropriate knowledge and industry expertise should be appointed to the review.

Recommendation 60: The government should continue to monitor tax concessions aimed at supporting environmental outcomes, and consider replacing them with targeted spending programs where this would be a more effective and efficient method of achieving the appropriate environmental outcome.

E3 — Road transport taxes

Recommendation 61: Governments should analyse the potential network-wide benefits and costs of introducing variable congestion pricing on existing tolled roads (or lanes), and consider extending existing technology across heavily congested parts of the road network. Beyond that, new technologies may further enable wider application of road pricing if proven cost-effective. In general, congestion charges should apply to all registered vehicles using congested roads. The use of revenues should be transparent to the community and subject to further institutional reform.

Recommendation 62: The Council of Australian Governments (COAG) should accelerate the development of mass-distance-location pricing for heavy vehicles, to ensure that heavy vehicles pay for their specific marginal road-wear costs. Revenue from road-wear charges should be allocated to the owner of the affected road, which should be maintained in accordance with an asset management plan. Differentiated compliance regimes to enforce this pricing policy may need to be considered to balance efficiency benefits from pricing against the costs of administration and compliance for some road users.

Recommendation 63: States should improve compulsory third party insurance to better reflect individual risks.

Recommendation 64: On routes where road freight is in direct competition with rail that is required to recover its capital costs, heavy vehicles should face an additional charge on a comparable basis, where this improves the efficient allocation of freight between transport modes.

Recommendation 65: Revenue from fuel tax imposed for general government purposes should be replaced over time with revenue from more efficient broad-based taxes. If a decision were made to recover costs of roads from road users through fuel tax, it should be linked to the cost of efficiently financing the road network, less costs that can be charged directly to road users or collected through a network access charge. Fuel tax should apply to all fuels used in road transport on the basis of energy content, and be indexed to the CPI. Heavy vehicles should be exempt from fuel tax and the network access component of registration fees if full replacement charges are introduced.

Recommendation 66: The revenue-raising component of State taxes on motor vehicle ownership and use should be made explicit, and over time only be used to recover those costs related to road provision. The administrative costs of providing government services should be recovered through user charges where applicable. Quantity limits on taxi licences should be phased out.

Recommendation 67: Governments should continue to reform road infrastructure provision, applying economic assessment to investments comparable to that for other forms of infrastructure.

Recommendation 68: COAG should develop a National Road Transport Agreement to establish objectives, outcomes, outputs and incentives to guide governments in the use and supply of road infrastructure. COAG should nominate a single institution to lead road tax reform, and ensure implementation of this agreement.

E4 — Housing affordability

Recommendation 69: COAG should place priority on a review of institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability.

Recommendation 70: COAG should review infrastructure charges (sometimes called developer charges) to ensure they appropriately price infrastructure provided in housing developments. In particular, the review should establish practical means to ensure that these charges are set appropriately to reflect the avoidable costs of development, necessary steps to improve the transparency of charging and any consequential reductions in regulations.

E5 — Alcohol taxation

Recommendation 71: All alcoholic beverages should be taxed on a volumetric basis, which, over time, should converge to a single rate, with a low-alcohol threshold introduced for all products. The rate of alcohol tax should be based on evidence of the net marginal spillover cost of alcohol.

Recommendation 72: The introduction of a common alcohol tax should be accompanied by a review of the administration of alcohol tax, to ensure that alcohol taxpayers do not face redundant compliance obligations.

E6 — Tobacco taxation

Recommendation 73: The existing regime for tobacco taxation in Australia should be retained, with the rates of tax substantially increased, depending on further evidence on the costs of harm from tobacco smoking.

Recommendation 74: Tobacco excise should be indexed to a broad measure of wages rather than CPI.

Recommendation 75: There should be no duty free allowance on tobacco for international travellers entering Australia.

E7 — Gambling taxation

Recommendation 76: Gambling taxes should be reviewed to ensure that they are focused on recouping economic rent generated by government restrictions on the supply of gambling services or are being used efficiently to impose such restrictions.

Recommendation 77: Governments should eliminate gambling tax concessions for particular types of gambling business, such as clubs. If governments wish to subsidise particular types of businesses, they should do so through direct expenditures.

Recommendation 78: Governments should consider the allocation of responsibilities for the regulation and taxation of gambling, with a view to minimising conflicts in policy-making between revenue-raising and addressing problem gambling.

E8 — Rationalising other taxes

Recommendation 79: All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption.

Recommendation 80: The luxury car tax should be abolished.

Recommendation 81: Governments should undertake a systematic review of existing and potential user charges and minor taxes against the principles set out in this report. This should be coordinated with the introduction of the system wide Tax and Transfer Analysis Statement proposed in Recommendation 132.

F — The transfer system

F1 — Income support payments

Recommendation 82: There should be three categories of income support payments:

- (a) A **pension category** for people who are not expected to support themselves through paid work, whether because of their age, disability or because they are providing full-time care for a person with disability (or frail aged). This pension would be paid at a rate that provides a basic acceptable standard of living, having regard to prevailing community standards.
- (b) A **participation category** for people of working age who are expected to support themselves through paid work now or in the near future. This would cover the unemployed including youth (both under and over 18), those who are temporarily incapacitated, people with a partial capacity to work and primary carers of dependent children. The rate of payment, for those who are expected to work, should provide a basic level of adequacy while maintaining incentives to work. This would be less than the pension rate. Parents on income support would receive a higher total level of payment. Unemployed youth aged less than 21 would be paid no more than full-time students to avoid creating incentives to leave full-time study for unemployment.⁹
- (c) A **student assistance category** for people engaged in full-time study. Students aged 21 and over would continue to be paid at a lower rate than the unemployed and at the same rate as younger students in similar circumstances. Some students have the capacity to work part-time to supplement their income support. Other students could be given the ability to borrow against future income to supplement their student assistance.¹⁰

Recommendation 83: There should be a more consistent approach to payment relativities within each of the three categories of payment based on the single to couple pension relativity. A more consistent approach would mean an increase to base rates for single income support recipients in the participation and student assistance categories. However, a lower relativity for singles in these categories without children may be warranted given their greater capacity to share accommodation.

⁹ Rates of payment for participation category customers aged less than 21 are discussed in Section F3 Family and youth assistance.

¹⁰ Rates of payment for student assistance category customers aged less than 22 are discussed in F3 Family and youth assistance.

Recommendation 84: Payments and income test parameters should be indexed in a consistent way to maintain relativities across the three payment categories and to reflect changes in community standards. Governments should regularly review indexation as community standards are likely to be affected by significant changes in the composition of the workforce and household incomes in coming decades. The current community standard for pensions is set by reference to Male Total Average Weekly Earnings. Indexing all payments to this standard has been projected to involve a significant increase in budgetary outlays over the coming decades so it will be necessary for governments to regularly review the appropriateness of this measure and the level of the benchmark.

Recommendation 85: Income support arrangements for parents should support and encourage participation in work while maintaining adequate levels of assistance to families. As a condition of payment parents should be required to look for part-time work once their youngest child turns four. Parents would receive supplements as follows:

- (a) For couples and single parents with a youngest child under six years, the amount of the supplement should be set such that the total support for single parents on income support will be equivalent to the maximum rate of pension. The supplement would be paid through the family payment system.
- (b) For single parents with a youngest child aged six or older, the supplement should be paid at a substantially lower rate through the family payment system.
- (c) For couples with a youngest child aged six years or older, the lower rate supplement should be paid through the income support system.

Recommendation 86: People with disability who have a partial capacity to work, excluding people receiving Disability Support Pension (DSP), should have a part-time work requirement. They should be subject to a means test or payment arrangements that provide an incentive to work part-time and that recognises that they face higher average costs of work. This could also be achieved by an in-work supplement and/or an earnings disregard in the means test.

Recommendation 87: Students should have access to an income test that facilitates significant part-time work at a level that does not compromise educational outcomes. Adults requiring additional income should be able to borrow to top up their student rate of income support to the level of the participation payment rate. The feasibility of using the existing income-contingent loans scheme and the potential impact of it on access to higher education of students from a low socioeconomic background should be examined.

F2 — Means testing

Recommendation 88: The current income and asset tests for income support payments should be replaced with a comprehensive means test based on a combined measure of employment income, business income and deemed income on assets. The comprehensive means test would:

- (a) extend deemed income on assets in addition to financial assets, including superannuation income streams, rental housing and other asset classes (whether income-producing or not). Superannuation income streams where deeming income would be difficult to apply would be tested on gross income but with an actuarially fair deduction for capital;
- (b) have low and high deeming rates based on the returns expected from a portfolio of assets held by a prudent investor. These rates should be set by reference to an appropriate benchmark;
- (c) continue the means test exemption for owner-occupied housing up to a high indexed threshold;
- (d) set a high capped exemption for personal-use assets;
- (e) retain the current concessional treatment of employment income for certain allowances and pensions;
- (f) have different free areas for pensions and allowances; and
- (g) remove the liquid assets waiting period and the sudden-death cut-out that applies to people on certain payments.

Recommendation 89: Means testing for family assistance payments should be based on the same measure of taxable income as for income tax, including fringe benefits. However, payments should not be reduced as a result of the inclusion of compulsory superannuation contributions in taxable income. Consideration should be given to aligning the definitions of income and periods of assessment for family assistance payments more closely to those that apply to income support payments. However, this should not include deeming income on assets.

F3 — Family and youth assistance

Recommendation 90: Current family payments, including Family Tax Benefit Parts A and B, should be replaced by a single family payment. The new family payment should:

- (a) cover the direct costs of children in a low-income family (that is, the costs associated with food, clothing, housing, education expenses); and
- (b) assist parents nurturing young children to balance work and family responsibilities.

Recommendation 91: The direct cost of children component of family assistance should be a per child payment.

- (a) Rates of payment should increase with the age of the children to recognise the higher costs of older children. Three rates of payment should apply: for 0–11 year olds; 12–15 year olds and 16–18 year olds while in secondary school. These age bands would appropriately accommodate the increasing costs of children (this would require higher payments rates for 12, 16 and 17 year olds). The Baby Bonus should be abolished and a small supplementary payment, reflecting the direct costs of a new-born baby, should be paid over the first three months.
- (b) A shared-care rate to recognise the higher costs of separated families should be considered, taking into account interactions with child support as well as other income support payments.
- (c) Additional payments for larger families, including the Large Family Supplement, the Multiple Birth Allowance for children over one year, and higher thresholds for larger families should be reconsidered as the case for these payments is not strong.

Recommendation 92: A supplement for parents nurturing young children (aged under six years) should be provided as a per-family payment, means tested on family income in addition to the recently announced Paid Parental Leave arrangements.

- (a) The maximum rate of the supplement should be set such that the total support for single parents wholly reliant on income support is equivalent to the maximum rate of pension.

Recommendation 93: For single parents with children aged six or older, a parental supplement (which should be considerably smaller than under Recommendation 92), should be paid through the family payment system.

Recommendation 94: For couples with children aged six or older, a parental supplement at the same rate as for single parents should be paid through the income support system (See Part Two Section A1 Personal income tax).

Recommendation 95: Assistance for families should also recognise that there are specific circumstances, such as parents caring for disabled children and foster care children with higher needs, for which additional support beyond the early years is appropriate.

Recommendation 96: The total amount of family assistance should be withdrawn with a single means test to avoid cumulative withdrawal rates which create unnecessarily high disincentives for working. A single low withdrawal rate of 15–20 per cent would be appropriate to minimise workforce disincentives.

Recommendation 97: While family payments should be the main form of assistance for families with children up to the end of secondary school, or the school year in which they turn 18 (the earlier of the two), youth payments should be available to older children in some circumstances.

- (a) Dependent older children for whom a suitable pathway may be leaving school and looking for work or combining part-time work and part-time study should have access to a youth payment, governed by strict participation requirements.
- (b) Children without access to financial support from their families should continue to have access to a youth payment, governed by strict criteria.

Recommendation 98: Youth payments should be the main form of income support from the age of 18 until the age of independence.

- (a) Family payments should not be provided for those aged 18 and over unless they are completing secondary school in the year they turn 18.
- (b) Youth payment rates should reflect the fact that most young people have lower needs than adults but need adequate assistance to participate in education and training.
- (c) Dependent youth payment recipients should be subject to a parental income test consistent with that applying to family payments. Family means tests should be designed so that families with dependent children in both the family payments and youth payments system are not disadvantaged.
- (d) The age of independence should be aligned for full-time students and non full-time students.

F4 — Child care assistance

Recommendation 99: Child Care Benefit and Child Care Rebate should be combined into a single payment to parents (or to child care centres) in respect of each child based on a percentage of child care costs. The payment should have the following features:

- (a) a high rate of subsidy for low-income families that covers most of the costs of child care (up to 90 per cent). This would involve a small co-payment for low-income families;
- (b) a base rate of assistance for all families that use child care to facilitate parental engagement in the workforce. The base rate of assistance should be set as a proportion of child care costs, with reference to the marginal tax rate faced by the majority of taxpayers. (Based on the indicative personal income tax rates scale in Part Two Section A1, this would indicate a rate of assistance of 35 per cent);
- (c) access to the base rate of assistance subject to a requirement that parents participate in work, education or training. Where parents are not participating, the maximum rate of assistance should be available for a limited number of hours. The number of hours subsidised without a participation requirement should be the same as the number of hours of universal access to pre-school (15 hours by 2013); and
- (d) coverage of the full costs of child care for at-risk children and children facing multiple disadvantages, without participation requirements on parents.

Recommendation 100: The child care payment should be means tested down to the base rate of assistance based on family income and should have regard to the interaction with other means tested payments (income support and family payments) and marginal tax rates, to ensure that effective marginal rates of tax are not excessive.

Recommendation 101: The fringe benefits tax exemption for child care facilities provided on an employer's business premises for the benefit of employees should be removed.

F5 — Housing assistance

Recommendation 102: The maximum rate of Rent Assistance should be increased to assist renters to afford an adequate standard of dwelling. To ensure that Rent Assistance can be maintained at an adequate level over time, the rent maximum should be indexed by movements in national rents, which could be measured by an index of rents paid by income support recipients.

Recommendation 103: To better target an increase in the maximum rate, Rent Assistance should be part of the income support system, with eligibility based on rent paid and the income support means test, rather than on eligibility for another payment (for example, Family Assistance).

Recommendation 104: Mechanisms should be developed to extend Rent Assistance equitably to public housing tenants along with removing income-linked rent setting in public housing.

Recommendation 105: A high-need housing payment should be paid to social housing providers for their tenants who have high or special housing needs or who may face discrimination in the private market. This payment should be funded by the Australian government. The Commonwealth and the States should retain the option of providing capital for social housing construction.

Recommendation 106: Income-linked rents should be phased out in social housing, with providers charging their tenants rents linked to the market rate, with existing rent-setting for current tenants phased out using grandfathering or other transitional arrangements. However, continued use of income-limited rents is appropriate in some circumstances, such as in remote Indigenous communities.

F6 — Transfers tied to goods and services

Recommendation 107: The Productivity Commission, constituted to include an appropriately qualified and experienced member, should review concessions across all levels of government and provide recommendations for consideration by COAG.

Recommendation 108: The Productivity Commission should examine the principles of public service delivery and the mechanisms that are available to governments to deliver public services and their implications for financial arrangements in the federation. The findings of this study should be considered by COAG.

F7 — Funding aged care

Recommendation 109: There is considerable scope to align aged care assistance with the principles of user-directed funding to provide assistance in line with recipients' needs, enable their choice of care and support the fiscal sustainability of the aged care sector. However, effective user-directed funding is significantly limited by regulations that govern supply and price, reforms to which would have complex sequencing and transition issues. As such, the Productivity Commission should consider this potential reform direction in its upcoming inquiry into aged care.

Recommendation 110: It is important for governments to determine what an adequate level of aged care should be, the necessary pricing and regulatory arrangements to deliver it, and the most sustainable funding arrangement to ensure access by those who cannot afford it. Given this, and noting that the Productivity Commission will be inquiring into the disability insurance scheme, its consideration of aged care should include the potential for insurance to play a role in helping to fund aged care as Australia's population ages.

G — Institutions, governance and administration

G1 — A responsive and accountable tax system

Recommendation 111: The government should establish a more transparent means of dealing with community ideas about the tax system by extending the Tax Issues Entry System website and further developing its use.

Recommendation 112: The government should commit to a principles-based approach to tax law design as a way of addressing the growing volume and complexity of tax legislation, and as a way of helping those laws to be interpreted consistently with their policy objectives.

Recommendation 113: The Board of Taxation should be empowered to initiate its own reviews of how current tax policies and laws are operating, in consultation with the government. This would be in addition to reviewing matters referred to it by the government, though it should not engage in substantive policy development unless requested by the government.

In giving effect to these changes to the nature and functions of the Board, the government should ensure that the Board has adequate resources (including its own permanent secretariat). The government should also consider:

- (a) how to manage the increased workload for the Board, including whether the Board would require further members and/or members who can devote more time to the Board;
- (b) whether the Secretary to the Treasury, the Commissioner of Taxation, and the First Parliamentary Counsel should be appointed as advisers to the Board, rather than as members; and
- (c) whether the Inspector-General of Taxation, the Auditor-General, the Commonwealth Ombudsman and the Chair of the Tax Practitioners Board should be appointed as advisers to the Board of Taxation.

Recommendation 114: Information or advice provided by Treasury to assist the ATO in determining the purpose or object of the law, or materials used by the ATO to determine policy intent (other than correspondence with or from government) should be made public.

Recommendation 115: A board should be established to advise the Commissioner of Taxation on the general organisation and management of the ATO. The board would not be a decision-making body and would have no role in interpreting the tax laws or examining individual taxpayer issues. The government would appoint members to the board.

Recommendation 116: The government should clarify that the role of the Inspector-General of Taxation is to examine systemic tax administration issues that affect businesses.

Recommendation 117: The government should ensure that sufficient resources are devoted to the functions of the Inspector-General of Taxation, the Australian National Audit Office and the Commonwealth Ombudsman, recognising their importance in maintaining a fair and efficient tax system.

Recommendation 118: The Joint Committee of Public Accounts and Audit should examine reports of the Inspector-General of Taxation and the Commonwealth Ombudsman, and monitor the ATO's implementation of the recommendations in those reports.

G2 — State tax reform

Recommendation 119: Reforms to State taxes should be coordinated through intergovernmental agreements between the Australian government and the States to provide the States with revenue stability and to facilitate good policy outcomes.

G3 — Local government

Recommendation 120: States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality.

Recommendation 121: Over time, State land tax and local government rates should be more integrated. This could involve:

- (a) moving to a joint billing arrangement so that taxpayers receive a single assessment, but are able to identify the separate State and local component; and
- (b) using the same valuation method to calculate the base for local government rates and land tax (with this method being consistent across the State).

G4 — Client experience of the tax and transfer system

Recommendation 122: A tax and transfer client account should be developed, based on customer research and with customer input into its design. The account should include at least the following features:

- (a) Up-to-date presentation of income earned from all sources, taxes withheld, tax liabilities incurred, transfers received and information flows from third parties;
- (b) complete information from past periods;
- (c) an optional single point for updating personal information, undertaking transactions, and reporting information or making applications, with extensive pre-filling of forms based on information previously provided; and
- (d) the ability to test the impact of hypothetical changes in circumstances.

Recommendation 123: Pre-filled personal income tax returns should be provided to most personal taxpayers as a default method of settling their tax affairs each year.

Recommendation 124: Existing tax and transfer provisions should be reformed to support improvements in client experience, including greater alignment of income definitions and reporting, rationalising of personal tax deductions and offsets, and streamlining of mandatory administrative requirements. Future new policy proposals should be subject to comprehensive, published expected impact assessments on client experience systems and outcomes.

Recommendation 125: Where possible, information required for determining tax liabilities and transfer entitlements should be collected from third parties, including employers, government agencies, financial institutions, and share and property registries.

- (a) Over time, electronic provision of this information by third parties should be made mandatory.
- (b) To reduce current and minimise new compliance costs, reporting obligations should as far as possible be aligned with existing information concepts and systems of third parties, and facilitated through electronic interaction with information held in the 'natural systems' of those entities.

Recommendation 126: Further approaches (extension to and approaches which build on Standard Business Reporting) should be pursued to reduce the compliance costs associated with business interactions with government.

Recommendation 127: The government should assist small businesses to be 'business ready' when they begin business. This could be achieved through education and financial assistance, which may include assistance to small business to get ready for Standard Business Reporting (SBR).

Recommendation 128: Common information standards, leveraging from the standards and governance put in place by the SBR Program, be developed and adopted to support system interoperability between tax and transfer agencies, and between those agencies and third parties, such as employers.

Recommendation 129: A modern privacy and secrecy framework be developed and adopted that maintains and streamlines protection of personal information held by government agencies, and facilitates exchange of information (other than an individual's health information) between agencies to support improved client experience of the tax and transfer system.

Recommendation 130: A method of linking records, for example by linking existing client identifiers, be developed to facilitate development of a single client account for tax and transfer financial information. This would allow better service delivery by supporting interoperability and data exchange between the appropriate government agencies, and flows of tax and transfer information from third parties to those agencies. Information should not include individual health information.

Recommendation 131: A high level taskforce be established, under central agency leadership, to progress a whole of government approach to improving the client experience of the tax and transfer system, with:

- (a) membership from relevant agencies, the private sector and client representatives;
- (b) terms of reference requiring the taskforce to:
 - develop, consult, oversee and regularly report to government and Parliament on a whole-of-system reform of the administrative arrangements and technologies that deliver the client experience of the tax and transfer system;
 - position these reforms within the overall government initiative to improve the relationship between it and citizens; and
 - lead consultations with relevant stakeholders, including citizens, privacy advocacy groups, professional associations, financial institutions and employers.
- (c) a mechanism for capturing feedback from citizens on government service delivery, including both current administration and new proposals.

G5 — Monitoring and reporting on the system

Recommendation 132: The government should, every five years, publish a Tax and Transfer Analysis Statement that analyses and reports on the overall performance and impact of the system, including estimates of efficiency costs and distributional impacts.

Recommendation 133: The Australian and the State governments should systematically collect data on aspects of existing taxes and transfers – including compliance cost data – according to consistent and transparent classifications and concepts, and make this information – including confidentialised tax unit records – freely available for further analysis and research.

Recommendation 134: The government should support one or more institutions to undertake independent policy research relevant to the Australian tax and transfer system.

Recommendation 135: The Australian government should ensure that the rules governing the development of the Budget encourage trade-offs between tax expenditures and spending programs. Budget decision-making processes should measure and treat tax expenditures and spending programs symmetrically, to ensure that there is no artificial incentive to deliver programs through one mechanism rather than another.

Recommendation 136: The government should introduce legislation to amend the *Charter of Budget Honesty Act 1998* to recognise the publication of detailed information about tax expenditures in a Tax Expenditures Statement separate from the Mid-Year Economic and Fiscal Outlook (MYEFO). However, the Tax Expenditures Statement should continue to be released by the end of January in each year, or within six months of the last Budget, whichever is later.

Recommendation 137: The government should ensure that reporting standards are independently developed for the identification and measurement of tax expenditures in the Tax Expenditures Statement. In addition, the standards should establish a basis for reporting the broader economic and distributional effects of tax expenditures in the periodic Tax and Transfer Analysis Statement (see Recommendation 132).

Recommendation 138: The Council of Australian Governments should examine the ways in which the States could uniformly report tax expenditures annually according to the independent standards developed under Recommendation 137.