



## Tax Laws Amendment (2006 Measures No. 5) Bill 2006

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## Tax Laws Amendment (2006 Measures No. 5) Bill 2006

**Date introduced:** 17 August 2006

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The Act commences on Royal Assent. The commencement and application of the Schedules are dealt with in the Main Provisions section of this Bills Digest.

### Purpose

The Tax Laws Amendment (2006 Measures No. 5) Bill 2006 ([the Bill](#)) has three Schedules and the purpose of each Schedule is briefly as follows.

- Schedule 1 proposes to make amendments to the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) to change the following fringe benefits tax (FBT) thresholds to:
  - increase the minor benefits exemption threshold from \$100 to \$300,
  - increase the reduction of taxable value that applies to eligible in-house fringe benefits and airline fringe benefits from \$500 to \$1,000, and
  - increase the reportable fringe benefits amount threshold from \$1,000 to \$2,000.

Schedule 1 also proposes to extend the FBT concessions for remote areas by broadening the definition of remote where the shortest practicable route to a remote area involves travel wholly or partially over water.

All these amendments will take effect for the FBT year commencing 1 April 2007 and later FBT years.

- Schedule 2 proposes GST concessions in relation to the military rehabilitation and compensation scheme (MRCS) established under the [Military Rehabilitation and Compensation Act 2004](#). The amendments in this Schedule which take effect from 1 July 2004, the date of commencement of the MRCS, will ensure that:
  - supplies of drugs, medicines and other pharmaceutical items are GST-free if supplied as pharmaceutical benefits under the MRCS, and
  - that the GST-free motor vehicle concession for veterans will be extended to include a new category of severely injured veterans under the Military Rehabilitation and Compensation Scheme (MRCS).
- Schedule 3 proposes amendments to the *Income Tax Rates Act 1986* to extend the full tax-free threshold of \$6,000 to taxpayers who cease to be engaged in full-time education for the first time from the year 2006–07; at present these taxpayers are only entitled to a proportion of the tax-free threshold of \$6,000.

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## Background and Main provisions

As there is no central theme to the Bill, the background to the various measures and the related main provisions will be considered under the amendments proposed by each Schedule.

### Schedule 1—Fringe benefits tax amendments

#### Background

##### Taskforce on reducing the regulatory burden on business

On 12 October 2005, the Prime Minister and the Treasurer in a [Joint Press Release](#) announced the appointment of a Taskforce to identify practical options for alleviating the compliance burden on business from Commonwealth Government regulation.<sup>1</sup> The terms of reference of the Taskforce were set out in the Joint Press Release as follows:

The Taskforce will:

- identify specific areas of Commonwealth Government regulation which are unnecessarily burdensome, complex, redundant or duplicate regulations in other jurisdictions;
- indicate those areas in which regulation should be removed or significantly reduced as a matter of priority;
- examine non-regulatory options (including business self-regulation) for achieving desired outcomes and how best to reduce duplication and increase harmonisation within existing regulatory frameworks; and
- provide practical options for alleviating the Commonwealth's 'red tape' burden on business, including family-run and other small businesses.

##### Report of the Taskforce on Reducing Regulatory Burdens on Business

The report of the Taskforce titled [Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business](#) (the report of the Taskforce) was released on 7 April 2006.<sup>2</sup> The report deals with tax and superannuation regulation in paragraphs 5.2 and 5.3 of Chapter 5, on pages 107 to 128. The need to streamline fringe benefits tax arrangements is covered on pages 114 to 117.

##### Government's interim and final response to the report of the Taskforce in respect of changes to the FBT regime

In a Joint Press Release of the Prime Minister and the Treasurer on 7 April 2006 entitled - [Government response to the report of the taskforce on reducing the regulatory burdens on business](#), the Australian Government gave its interim response to the report of the Taskforce.<sup>3</sup> This interim response included the following recommended changes to the FBT regime:

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- an increase in the minor fringe benefits exemption threshold from \$100 to \$300, effective from 1 April 2007;
- an increase in the fringe benefits reporting exclusion threshold from \$1000 to \$2000, effective from 1 April 2007;

On 15 August 2006, the [final response](#) of the Australian Government to the report of the Taskforce was [released](#) by the Treasurer.<sup>4</sup> This Bill only implements the above recommendations that were in the interim response in relation to FBT. It does not implement the additional recommendations that were in the final response.

### Changes to the FBT regime announced in the 2006 Budget

There were two FBT measures announced in the 2006–07 Budget which are implemented by this Bill. They relate to the following:

- the increase in the in-house fringe benefits tax-free threshold from \$500 to \$1,000, with effect from 1 April 2007, and
- the broadening of the FBT definition of remote where the shortest practicable route involves travel over water, with effect from 1 April 2007.<sup>5</sup>

### Main provisions

#### Increasing the threshold for the exemption of minor benefits

Section 58P of the FBTAA 1986 provides for certain minor benefits to be exempt from FBT. Airline transport benefits and in-house fringe benefits are not covered by the exemption of minor benefits under section 58P. Subsection 58P(1) sets out the tests for exemption and paragraph 58P(1)(e) requires that the notional taxable value be less than \$100. **Item 1 of Schedule 1** amends paragraph 58P(1)(e) by increasing the threshold to \$300 and is in accordance with Recommendation 5.31 on page 116 of the report of the Taskforce.

#### Financial impact

The [Explanatory Memorandum](#) to the Bill states at page 4 that this measure will have the following revenue implications.<sup>6</sup>

	2006–07	2007–08	2008–09	2009–10
Increase the minor benefits exemption threshold	Nil	-\$3m	-\$1m	-\$2m

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### Increasing the threshold for reduction of aggregate taxable value of certain fringe benefits

Section 62 of the FBTAA 1986 provides for the reduction of aggregate taxable value of one or more eligible fringe benefits in relation to an employee for a year of tax. The eligible fringe benefits are an in-house fringe benefit or an airline transport fringe benefit.

If the taxable value or the sum of the taxable values does not exceed \$500, the reduction under paragraph 62(1)(a) is equal to the taxable value or the sum of the taxable values.

In any other case, the reduction under paragraph 62(1)(b) is \$500.

**Item 2 of Schedule 1** substitutes \$1,000 for \$500 in paragraphs 62(1)(a) and (b) to increase the threshold for the reduction of the taxable value in respect of these eligible fringe benefits for each employee for a tax year.

As indicated above, this measure was announced in the 2006–07 Budget.

#### Financial impact

The [Explanatory Memorandum](#) to the Bill states at page 4 that this measure will have the following revenue implications.

	2006–07	2007–08	2008–09	2009–10
Increase the reduction of taxable value that applies to eligible fringe benefits	Nil	-\$10m	-\$10m	-\$10m

### Increasing the threshold for employee's reportable fringe benefits amount

Under subsection 135P of the FBTAA 1986 an employee has a reportable fringe benefits amount for a year of income, if the employee's individual fringe benefits amount for the year of tax ending on 31 March in the year of income, in respect of the employee's employment by the employer is more than \$1,000.

**Item 3 of Schedule 1** substitutes \$2,000 for \$1,000 in subsection 135P(1) to increase the threshold of the reportable fringe benefits amount to \$2,000. This measure implements part of the Recommendation 5.30 on page 116 of the report of the Taskforce.

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## Financial impact

The [Explanatory Memorandum](#) to the Bill states at page 4 that this measure will have the following revenue implications.

	2006–07	2007–08	2008–09	2009–10
Increase the reportable fringe benefits amount threshold	Nil	Nil	-\$2.1m	-\$2.1m

## Broadening the definition of 'remote' for FBT concessions for remote areas

Section 140 of the FBTAA 1986 provides a test of remoteness from the nearest eligible urban area for certain remote area FBT concessions including the exemption for certain remote area housing benefits and the reduction in the taxable value of certain benefits arising from housing assistance.

Subsection 140(2) provides that distance is to be measured by the shortest practicable surface route between a point in the nearest eligible urban area and a point tested for remoteness. **Item 6 of Schedule 1** inserts **new subsection 140(2A)** which includes a formula for ascertaining the shortest practicable surface route where the eligible urban area and the tested location includes a route by water.

The effect of this formula is to double the kilometres between a location and the nearest eligible urban area where the shortest practicable route involves travel over water only. Where the shortest practicable route involves travel over both land and water, the total number of kilometres by water are doubled and added to the total number of kilometres by land.

This measure recognises that it is generally more difficult and inconvenient to travel over water than to travel over land.

## Financial impact

The [Explanatory Memorandum](#) to the Bill states at page 4 that this measure will have the following revenue implications.

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	2006–07	2007–08	2008–09	2009–10
Extend the definition of remote	Nil	-\$1m	-\$1m	-\$1m

### Commencement and Application

**Item 2** in **Column 1** of the table in **proposed section 2** of the Bill provides that **Schedule 1** commences on 1 April 2007.

**Item 7** of **Schedule 1** provides that the amendments made by Schedule 1 apply in relation to the FBT year starting on 1 April 2007 and later FBT years.

### Schedule 2—GST car and pharmaceutical concessions

#### Extension of the GST-free motor vehicle concession for veterans

##### Background

In a [Press Release](#) on 11 May 2004, Senator Helen Coonan the former Minister for Revenue and Assistant Treasurer announced that Government would extend the GST-free motor vehicle concession for veterans to include a new category of severely injured veterans under the Military Rehabilitation and Compensation Scheme (MRCS) established under the [Military Rehabilitation and Compensation Act 2004](#) (MRCA 2004). Senator Coonan added that:

Currently, only veterans who have lost (or effectively lost) a leg or both arms or are on a Totally and Permanently Incapacitated pension under the *Veterans' Entitlements Act* are eligible for a GST-free car.

“This measure will extend the GST-free car concession to the new category of severely injured veterans in the MRCS,”...<sup>7</sup>

##### Main provision

Paragraph 38–505(i)(b) of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) provides that a supply is GST-free if it is the supply of a car to an individual who has served in the Defence Force or in any other armed forces of Her Majesty, and

(b) as a result of that service:

- (i) has lost a leg or both arms, or
- (ii) has had a leg, or both arms, rendered permanently and completely useless, or

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- (iii) is a veteran who receives a pension under Part II under the *Veterans' Entitlements Act 1986*.

**Item 3 of Schedule 2** adds **new paragraph 38–505(1)(b)(iv)** to include an individual who is receiving a Special Rate Disability Pension under Part 6 of Chapter 4 of the MRCA 2004, or satisfies the eligibility criteria in section 199 of that Act. The eligibility criteria in section 199 are:

- the person is receiving compensation worked out under Division 2 of Part 4 as a result of one or more service injuries or diseases;
- as a result of the injuries or diseases, the person has suffered an impairment that is likely to continue indefinitely;
- the Military Rehabilitation and Compensation Commission has determined under Part 2 that the person's impairment constitutes at least 50 impairment points;
- the person is unable to undertake remunerative work for more than 10 hours per week, and rehabilitation is unlikely to increase the person's capacity to undertake remunerative work.

## Extension of GST-free pharmaceutical concessions for veterans

### Background

The Explanatory Memorandum to the Bill states at page 4 that the amendments regarding the extension of GST pharmaceutical concessions when supplied as pharmaceutical benefits under the MRCS have not previously been announced. The MRCS was established under the MRCA 2004.

### Main provisions

Subsection 38–50(4) of the GST Act provides that a supply of a drug, medicine or other pharmaceutical item is GST-free if the supply is on a prescription, and

- (a) is supplied as a pharmaceutical benefit within the meaning of section 91 of the *Veterans' Entitlements Act 1986*, and
- (b) it is supplied under an approved scheme with the meaning of section 91 of that Act.

**Item 3 of Schedule 2** adds **new subsection 38–50(4A)** so that a similar concession also applies when a drug, medicine or other pharmaceutical item is supplied on prescription:

- (a) as a pharmaceutical benefit under section 5 of the MRCA 2004, and
- (b) is supplied in accordance with a determination made under paragraph 286(1)(c) of that Act.

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## Financial impact

The Explanatory Memorandum to the Bill states at page 4, that the financial impact of the measures in Schedule 2 is negligible.

## Commencement and Application

**Item 3 in Column 1** of the table in **proposed section 2** of the Bill provides that **Schedule 2** commences on the day on which this Act receives the Royal Assent.

**Item 4 of Schedule 2** provides that the amendments made by Schedule 2 apply to net amounts for tax periods starting or that started, on or after 1 July 2004.

## Schedule 3—Removing part-year tax-free threshold for taxpayers who have ceased to be full-time students

### Background

Under Division 4 of Part II of the [Income Tax Rates Act 1986](#) (ITRA 1986) a taxpayer who ceases full-time education for the first time is not eligible for the full tax-free threshold of \$6,000 for the year of cessation of full-time studies. Such a taxpayer is entitled to a pro-rata tax-free threshold worked out by multiplying the number of months in the income year that the taxpayer was not studying full-time by \$500, which is the monthly equivalent of the tax-free threshold.

If the taxpayer received income in the pre-workforce period of the relevant income year (the period when the taxpayer was a full-time student), subsection 20(1) of the ITRA 1986 provides a formula for working out the threshold, which is obtained by adding to the reduced threshold so much of income derived in the pre-workforce period to bring it up to the standard tax-free threshold for the year.

Budget Paper No. 2 , 2006–07 stated at page 25 that Government will remove the part-year tax-free threshold for taxpayers ceasing full-time education , with effect from the 2006–07 income year.<sup>8</sup> It added at page 26 that this will reduce compliance costs as follows:

This will reduce compliance for taxpayers who have finished full-time education for the first time by removing the requirement for these taxpayers to calculate a part-year tax-free threshold and will end the requirement for taxpayers to isolate income (and any deductions) attributable to the period during which a taxpayer was engaged in full-time study.

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## Main provision

To give effect to this measure:

- **item 7 of Schedule 3** repeals sections 17 and 19 of the ITRA 1986, which define part-year workforce period and pre-workforce income respectively.
- **item 8 of Schedule 3** repeals subsection 20(1) in its present form.

**Item 8** substitutes a **new subsection 20(1)** to deal with the threshold applicable to a part-year residency for taxpayers generally.

## Financial impact

The explanatory Memorandum to the Bill at page 5 states that this measure will have the following revenue implications.

2006–07	2007–08	2008–09	2009–10
Nil	-\$2m	-\$2m	-\$2m

## Commencement and Application

**Item 3 in Column 1** of the table in **proposed section 2** of the Bill provides that **Schedule 3** commences on the day on which this Act receives the Royal Assent.

**Item 9 of Schedule 3** provides that the amendments made by this Schedule apply to assessments for the 2006–07 year of income and later years of income.

## Concluding comments

Do the amendments to the FBT regime proposed in the Bill and those announced recently go far enough in meeting calls for a comprehensive reform of the FBT regime?

As mentioned above, this Bill implements two of the recommendations in the report of the [Taskforce on Reducing Regulatory Burdens on Business](#) titled *Rethinking Regulation* (the report of the Taskforce). The final response of the Australian Government to the report of the Taskforce which was released by the Treasurer on 15 August 2006 included the acceptance of the further specific recommendation relating to FBT, namely, the exclusion from FBT reporting for pooled motor vehicles.<sup>9</sup>

The Explanatory Memorandum to the Bill at page 4 states that the FBT measures implemented by this Bill are expected to reduce compliance costs for employers and consequently reduce regulatory burdens on business.

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However, the initial reactions to the acceptance by the Government of the FBT recommendations in the Taskforce report is that they do not go far enough to ease the regulatory burdens. In an article titled [Tinkering falls short of much-needed tax revamp](#) in the Australian Financial Review of 29 August 2006, Mark Fenton-James makes the following comments:

The latest changes to the way GST and fringe benefits tax are calculated by small businesses are welcome measures to reduce the compliance burden. But it is only tinkering on the margin, as the whole tax system needs to be revamped with small business in mind.

Mark Fenton-James summarises the comments made by Pitcher Partners manager Gary Mathews on the FBT changes as follows:

He says the government needs to take a more fundamental approach and evaluate the whole FBT legislation, which is about 20 years old, to see if changes in business practices during the past two decades should be reflected in broader changes to the legislation.

Views of the Institute of Chartered Accountants in Australia for the overhaul of the FBT regime

The need for fundamental change in the design of the FBT regime expressed above echoes the [views](#) of the Institute of Chartered Accountants in Australia (ICAA) that the case has never been stronger for an overhaul of Australia's fringe benefit tax.<sup>10</sup> The ICAA published a report in March 2006 entitled *Fringe benefit tax design: decision time*. This report was written by Associate Professor Neil Warren of ATAX, Faculty of Law, University of New South Wales. This report argues that there are substantial economic efficiency, equity and simplicity gains to be had from three major reforms:

1. The taxation of fringe benefits in the hands of the employee (rather than the employer).
2. Valuing all benefits at cost (rather than some concessionally, such as with motor vehicles)
3. Raising the threshold below which minor fringe benefits are tax-exempt income.<sup>11</sup>

Recommendation 4 of the ICAA report recommended that the exempt minor fringe benefits threshold which is \$100 at present should be increased to \$200, in line with the Consumer Price Index (CPI) increases since the introduction of FBT in 1986. Further, the report suggested that the threshold should also be indexed regularly. The measure in the Bill goes further than the threshold suggested in the ICAA report in fixing it at \$300, although there is no provision for regular indexation. Recommendation 5.48 of the report of the Taskforce recommended that the Board of Taxation should develop a systematic approach to adjusting thresholds in tax law. The Australian Government has in its final response to the report of the

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Taskforce indicated at page 65 that it has accepted Recommendation 5.48 and referred to the Board of Taxation the question of developing a systematic approach to adjusting thresholds in tax laws.

The major reform in paragraphs 1 and 2 above which ICAA proposed in March 2006 will require a complete revamp of the FBT regime.

### Views of the Taxation Institute of Australia

[Report Beyond 4100](#) (May 2006) by Professor C. John Taylor is a report on measures to combat rising compliance costs through reducing tax law complexity, commissioned by the Taxation Institute of Australia (TIA).<sup>12</sup>

In a foreword to the report, the President of the TIA states that *Beyond 4100* had its genesis in the Board of Taxation's (the Board) project to identify inoperative provisions which aimed at reducing the size of tax laws by 4100 pages. This project of the Board has culminated in the Tax Laws Amendment Bill (Repeal of Inoperative Provisions) Bill 2006, which was introduced into the House of Representatives on 22 June 2006.<sup>13</sup>

The President adds, in the foreword, that the project of the Board did not look at instances where policy simplification could also give rise to a reduction in complexity and the resultant reduction in compliance cost dividend. This led to the TIA conducting a complementary research project focussing on identifying generic causes of complexity in the Australian income tax system, and giving some specific examples of complexities attributable to each generic cause.

*Beyond 4100* points out that the introduction of the obligation to disclose reportable fringe benefits on group certificates (now PAYG Summary Statements) arguably negates a major justification for levying FBT on employers (paragraph 2.12, page 24).

Further, *Beyond 4100*, in Chapter 8 on pages 72 and 73 argues that there is a case for a comprehensive rewrite of Australia's income and fringe benefits tax laws. This call for a rewrite of the FBTAA 1986 is also made against the background that the Tax Laws Amendment (Repeal of Inoperative Provisions) Bill 2006 when enacted will only reduce the 468 pages of the FBTAA 1986 by one quarter of a page.

### Limitations on the scope for review of tax laws by the Taskforce

*Rethinking Regulation*, the report of the Taskforce on Reducing Regulatory Burdens on Business points out at pages 110 and 111 that tax compliance costs may be divided into two broad categories, namely:

- the cumulative burden of tax compliance, and
- specific concerns with the tax law, such as aspects of fringe benefits tax, GST, income tax and tax administration.

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The recommendations made in the report of the Taskforce in relation to FBT are intended to address some specific concerns. The report states that the review of tax laws generally in reducing the cumulative burden of tax compliance was beyond the scope of the review of tax laws by the Taskforce and indicates future directions for the design of tax laws:

Reducing the cumulative burden of tax compliance is inherently more difficult than responding to specific pressure points, and raises fundamental policy tradeoffs which are beyond the scope of this review. Tax is different to other areas of regulation in that the instrument for collecting revenue is often an integral part of government policy.

However, business desire for government to tackle the cumulative tax compliance burden was a strong and recurring theme of submissions. Ultimately, tax law design must take into account the cumulative compliance burden, or impose significant and unproductive costs on society. As a result, the Taskforce reaffirms the importance of a number of tax design principles that it considers would help government develop longer term solutions to reducing tax compliance costs.

The Australian Government should give priority to the following principles when developing future tax changes:

1. Tax system design should be predominately about raising revenue efficiently using a 'broad-base, low-rate' approach.
2. Direct expenditure, including the social security system and direct grants, should be used to achieve equity objectives and compensate for tax changes.
3. Measures to protect the revenue base must balance the revenue risk against the costs of compliance.
4. Effective consultation with business and good tax design are fundamental to ensuring that tax decisions adequately account for compliance costs.

The report of the Taskforce had in Recommendation 5.48 indicated certain issues for consideration by the Board of Taxation in its current scoping study of small business compliance costs including the simplified tax system and a systematic approach to adjusting thresholds in tax laws. The Australian Government's final response to this report at page 65 stated that it agreed with this recommendation.

The Treasurer, in Press Release No. 088 of 15 August 2006 in releasing the Australian Government's final response to the report of the Taskforce, indicated that the Office of Regulation Review in the Treasury portfolio will be strengthened and reoriented, becoming the Office of Best Practice Regulation. The Treasurer added:

It will work closely with government agencies as they develop policy proposals in order to prevent the generation of unnecessary new regulation. Furthermore, the Government is mandating appropriate levels of regulatory analysis, including through the use of the 'Business Cost Calculator', also available to businesses, to quantify in dollar terms the compliance cost of proposed regulatory options. The Government will also undertake

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annual reviews to examine the cumulative stock of regulation and identify an ongoing red tape reduction agenda.

## Endnotes

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1. The Hon John Howard, MP, the Prime Minister and the Hon Peter Costello, MP, the Treasurer, [Taskforce on reducing the regulatory burden on business](#), Joint Press Release, Parliament House, Canberra, 12 October 2005.
2. Regulation Taskforce 2006, [Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business](#), Report to the Prime Minister and the Treasurer, Canberra, January 2006.
3. The Hon John Howard, MP, the Prime Minister and the Hon Peter Costello, MP, the Treasurer, [Government response to the report of the taskforce on reducing the regulatory burdens on business](#) (interim response), Joint Press Release, Parliament House, Canberra, 7 April 2006.
4. Australian Government, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, [Australian Government's Response](#), (final response), 15 August 2006.
5. Budget Measures 2006-07, Budget Paper No. 2, p.19. These measures were also announced in Attachment B of the Treasurer's [Press Release No. 039](#) of 9 May 2006.
6. Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 5) Bill 2006, p. 4.
7. The Hon Senator Helen Coonan, the former Minister for Revenue and Assistant Treasurer, [GST and the extension of the concession for veterans' cars](#), Parliament House, Canberra, 11 May 2004.
8. Budget Measures 2006-07, Budget Paper No. 2, pp.25-36. These measures were also announced in Attachment B of the Treasurer's [Press Release No. 039](#) of 9 May 2006.
9. The Hon Peter Costello, MP, the Treasurer, [Report of the Taskforce on reducing regulatory burdens on business- Final Government response](#), Press Release No. 088, Parliament House, Canberra, 15 August 2006.
10. The Institute of Chartered Accountants of Australia: *Thought Leadership*. Available at <http://www.icaa.org.au/news/index.cfm?menu=358&id=A118085019> on 4 September 2006.
11. [Fringe benefit tax: decision time](#), Executive summary, p. 05.
12. Taxation Institute of Australia, *Beyond 4100, A report on measures to combat compliance costs through reducing tax law complexity*, (May 2006). Available at [http://www.taxinstitute.com.au/files/Taylor\\_Report\\_24\\_May\\_06\\_FINAL.pdf](http://www.taxinstitute.com.au/files/Taylor_Report_24_May_06_FINAL.pdf) on 5 September 2006.
13. Readers may refer to Bills Digest no. 14, 2006-07, of 14 August 2006 on the Tax Laws Amendment (Repeal of Inoperative Provisions) Bill 2006 which includes a general assessment of the impact of the repeal and savings provisions in this Bill on the work of tax practitioners.

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