



THE TAX INSTITUTE

24 August 2020

The Hon Josh Frydenberg MP Treasurer
C/- Budget Policy Division
The Treasury Langton Crescent
PARKES ACT 2600

By email: josh.frydenberg.mp@aph.gov.au, prebudgetsubs@treasury.gov.au

Dear Treasurer,

2020-21 Federal Budget Submission

The Tax Institute welcomes the opportunity to make an additional submission in response to the call by the Minister for Housing and Assistant Treasurer, the Hon Michael Sukkar, on 27 July 2020 for such submissions from individuals, businesses and community groups on their views regarding priorities for the 2020-21 Budget.¹

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to Appendix A for more about The Tax Institute.

We have previously prepared and lodged a submission dated 23 October 2019 (**first submission**) in relation to the 2020-21 Federal Budget (refer to Appendix C). However, given the impact of the COVID-19 pandemic, The Tax Institute considers that it is necessary to make additional submissions in relation to the 2020-21 Budget.

Summary

The COVID-19 pandemic has brought about unforeseen challenges to the Australian people and has had enduring detrimental effects on the economy and public resources. The Australian Government has been swift in its response, taking precautions and preventive measures to effectively slow the spread. Some measures, such as social distancing, border closures and the disruption of certain activities and events have contributed to the economic recession Australia now faces. While providing vital support to Australian individuals and businesses in crisis, economic stimulus measures provided by the Government have increased the Government's deficit and reduced its revenue.

¹ <https://ministers.treasury.gov.au/ministers/michael-sukkar-2019/media-releases/2020-21-pre-budget-submissions-0>

Now is the time for the Government to direct its attention and resources to rebuilding the Australian economy. In a post-pandemic landscape, this requires a thorough review and reform of the existing Australian tax system. It is only through significant reforms to the tax system that the Government will be able to generate sufficient revenue in the long-term to support public expenditure.

The Tax Institute is currently undertaking a major project to engage with our members and other stakeholders on key issues in the tax system and to identify options for reform. We will make these findings available to the Government towards the end of the year.

As outlined in our first submission in relation to the 2020-21 Budget, The Tax Institute submits that certain trade-offs will have to be made between current features of the tax system. Some trade-offs will require the repeal or reform of certain existing measures which may reduce revenues and narrow the tax base. However, others, such as the removal or limitation of certain exemptions and concessions, will broaden the tax base and increase revenue. The Tax Institute considers that key trade-offs will require reducing the corporate tax rate, broadening the GST base and overhauling the stamp duties regime.

Further, within the existing tax system, there are several key areas which require the Government's immediate attention. The Board of Taxation has published reports on many of these issues, such as the reform of individual tax residency rules and a review of the small business tax concessions, on which the Government has yet to respond. There is uncertainty and inefficiency in the application of a number of existing tax measures, such as the alienation of personal services income rules, the corporate tax residency rules and the operation of Division 7A. Further, there are more than 80 announced but unenacted measures in relation to which the Government must urgently clarify its intention.

We invite the Government to consider our further submission and request with respect that urgent action is taken to improve the Australian tax system for all in this critical time in our history.

Please refer to Appendix B for our detailed analysis supporting this submission.

If you would like to discuss any of the above, please contact either myself or Andrew Mills, Director Tax Policy & Technical, on 02 8223 0005.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Peter Godber', with a long horizontal flourish extending to the right.

Peter Godber
President

APPENDIX A

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of almost 12,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.

APPENDIX B

Australian tax system — comprehensive review and reform

The Tax Institute calls for an independent review of Australian tax system and its efficacy in the post-COVID-19 pandemic landscape. Taxpayers and businesses operate at the federal and state level and across states. The tax system in Australian is not one or the other of these but the whole of the system together across the different levels of government. An approach which considers federal and state taxes separately overlooks the economic reality that individuals and businesses operate in a commercial environment that crosses borders, domestically and internationally. This requires support from, and cooperation with, the States and Territories, particularly where reforms may reduce revenues historically collected by the States in favour of broadening the federal tax base.

The current tax system reflects decades of successive governments adding new provisions and ideas on top of existing provisions without properly considering the interrelationship between different parts of the law and how they impact activities and behaviours. One can often see that the original provision has been so layered with changes that the rule's reason for existence has been lost and it only adds to the confusion of our complex and overburdening laws. Additionally, court cases continue to reveal deficiencies in our tax law, from capital gains to the international tax area where double taxation often still inappropriately arises.

This has resulted in the well-recognised high annual cost of tax compliance which impedes the Government's ability to achieve its objectives. It hinders economic growth, and limits opportunities for job creation and investment; two critical areas for development in the post-pandemic landscape. Simplifying the Australian tax system, for example through the repeal of certain ineffective taxes, will free up resources currently allocated to compliance activities to be redistributed to other areas of need. Some previous announcements should also be reconsidered as they work against an efficient tax system that contributes to economic growth and the import of capital. By taking a holistic approach to reviewing the Australian tax system, the Government can ensure the system helps Australian individuals and businesses to recover from the detrimental impact of the COVID-19 pandemic and supports the growth of the economy in the years ahead.

Historically, there have been a number of reviews of the Australian tax system and particular aspects thereof that have been conducted at the state or federal level. The Tax Institute considers that a new comprehensive review can leverage the findings from previous reviews in an assessment of the current system. Key recurring themes that have emerged from these reviews relate to the personal marginal tax rate system; the deductibility of work-related expenses; the corporate tax rate; and the GST rate and base. The Tax Institute's view on these issues is summarised below and we refer you to our detailed analysis on these matters included in our original submission at Appendix C.

Personal marginal tax rate system

In The Tax Institute's view, there should be a fully transparent personal marginal tax rate system so that individual taxpayers can clearly identify which marginal tax bracket they fall into and the rate of tax that will therefore apply. Additional levies and income tax offsets unnecessarily complicate the personal tax rate system and distort the real impost of tax to taxpayers by dealing with social security matters through the tax system (for example via tax offsets).

The Tax Institute sees merit in any holistic review addressing all relevant levies and offsets with a view to adjusting marginal tax rates to accommodate the removal of levies or offsets as appropriate.

Deductibility of work-related expenses

Related to the individual tax system is the issue of the deductibility of work-related expenses. The Tax Institute considers that, in the short term, a standard deduction for work-related expenses should be introduced together with the option to claim actual expenses properly substantiated for employees with expenses above the standard deduction threshold. This would make it much simpler for individuals/employees to comply with their personal tax obligations. It would also provide opportunities to further simplify the administration of the tax system and reduce the cost to government of that administration.

Reduction of the corporate tax rate

The Tax Institute is of the view that a single corporate tax rate across all companies should apply in Australia. Currently, Australia operates a dual corporate tax rate system: a headline rate of 30% that applies to all companies other than to 'base rate entities' with a lower aggregated turnover and income that is not predominantly passive, to which a lower rate applies. Complex issues arise as a result in relation to determining a company's franking rate. Australia's headline corporate tax rate is the second highest in the OECD. The current dual tax rate system adds unnecessary complexity to the corporate tax system and produces anomalous outcomes.

We consider that a lower rate, no higher than 25%, should apply to all companies irrespective of their aggregated turnover or proportion of passive income. With a corporate tax rate of 25%, Australia would remain in the top one-third of OECD countries' highest corporate income tax rates. In the Asia-Pacific region, such a rate is substantially higher than the headline corporate tax rate of neighbouring countries. This lower rate still leaves Australia in a relatively uncompetitive position in the Asia-Pacific region. However, given the contentious debate surrounding the reduction of the rate, it is viewed as a step in the right direction.

GST base and rate reform

A comprehensive review of the current exemptions and special rules in the GST law which impact the scope of the GST base is required. Australia's current tax system relies heavily on income tax bases (both personal and corporate) for the majority of the revenue collection. This is out-of-step with Australia's counterparts in the Organisation for Economic Co-operation and Development (**OECD**) whose tax systems rely more heavily on broad-based consumption taxes.

This is an area where The Tax Institute submits trade-offs must be made for the overall improvement of the system and benefit of Australian taxpayers. There is a trade-off between making concessions and exemptions available for certain classes of taxpayers and the increased revenue that could be obtained from removing them. Further, where the GST base can be broadened by the limitation or repeal of certain concessions and exemptions, this should allow for reductions in other tax bases, such as corporate and income taxes, or a shift away from less efficient taxes such as the 115 taxes that contribute very little to revenue. This can be the case even after appropriate compensation for those on lower incomes.

Fringe Benefits Tax compliance costs

The Fringe Benefits Tax (**FBT**) is a primary example of a tax where the compliance costs significantly outweigh its contribution to overall revenue. In 2018-19, the FBT contributed just 0.89% of the revenue collected by the Federal Government.

The Board of Taxation has been undertaking a *Fringe Benefits Tax Compliance Cost Review* involving several research initiatives to estimate and identify the basis for FBT compliance costs and opportunities to reduce such costs.

The Tax Institute supports this review and recommends that the Government take this opportunity to fundamentally reconsider the FBT in light of its disproportionately high compliance costs and importantly, work towards reducing the regulatory red tape. The FBT rules have become antiquated and need reforming to reflect contemporary work practices and behaviours. A tax that has to include an exemption for the provision of toilet facilities to employees is a badly designed and poorly targeted tax. This is but one of many examples that cause FBT to be the subject of ridicule which thereby undermines the tax.

Stamp duties on property transactions

The *NSW Review of Federal Financial Relations: Supporting the road to recovery* report (**Thodey Report**), published in July 2020 sets out a number of recommendations relating to the reform of state taxes and duties, among other measures.

Stamp duty creates an onerous hurdle to the acquisition of property, particularly for first-home buyers. Land tax on the other hand, is spread over a period of time with the effect that, even in cases where the ultimate cost is about the same, purchasers are not required to pay the full amount at the outset, a factor which in itself can deter otherwise beneficial sale and purchase transactions. Further, land tax is a more equitable alternative because it takes the value of the land as a measure of the benefits accruing to the area in which the land is located from amenities and resources such as infrastructure, and health and other community services. This means that Australians contribute tax more fairly, regardless of how frequently they relocate.

The Tax Institute agrees with the recommendation in the Thodey Report that stamp duties on property transfers should be repealed and replaced with a broad-based land tax. The Thodey Report contains a number of potential models for this transition. We recommend the Government consider the various models outlined in the Thodey Report and cooperate with the States, particularly to provide assurance that they will not be adversely affected by a loss of GST-share as a result of such reforms. Consideration would need to be given to those property owners who have previously paid stamp duties on the acquisition of their properties.

Inefficient State taxes — insurance taxes and duties as an example

Insurance taxes and duties are an inefficient and complicated area of the Australian tax system. By driving up the price of insurance premiums, insurance taxes make policies prohibitive, particularly for lower income households. The Tax Institute agrees with the recommendation contained in the Thodey Report that all insurance taxes and duties should be promptly repealed. Revenue streams should be replaced with more efficient and equitable taxes.

The Thodey Report suggests a number of alternatives, some which have more relevance to particular insurance taxes than others. For example, in the case of funding of fire and emergency services, a broad-based property levy is considered more efficient from a tax perspective and more affordable for property owners overall. Other insurance taxes can be replaced by revenue from other taxes such as a broad-based land tax. The abolition of insurance taxes would simplify the tax system for Australian taxpayers and improve the accessibility of insurance to all Australians. As part of a comprehensive review and reform, there should be a cooperative approach across governments to address inefficient taxes such as these that have negative consequences for the efficient operation of the economy.

Payroll taxes

Like the Federal Government, the States and Territories are experiencing significant budget deficits due to the impact of the COVID-19 pandemic. Payroll tax is a significant source of revenue for the States and Territories, accounting for approximately one-third of revenues each year.²

² www.abs.gov.au/ausstats/abs@.nsf/mf/5506.0

However, it has been identified as one of our nation's most inefficient taxes, largely due to the discrepancies between the jurisdictions in the relevant thresholds and exemptions available. This invariably imposes a heavy compliance burden on employers and the State and Territory Revenue Authorities alike.

Australian businesses that operate across several States and Territories are faced with different reporting and payment obligations and are required to deal with different Revenue Authorities in each jurisdiction. Consistency in the payroll tax base across the States reduces the compliance burden for such taxpayers. Further, lockdown and social distancing measures which have disrupted the way businesses have traditionally operated have meant that consistency across state taxes such as payroll tax is more important than ever before.

The Tax Institute supports action to further harmonise the payroll tax base across the States and Territories. This requires cooperation between the State and Federal Governments and importantly, support from the Federal Government. Particularly in this time of economic crisis, it is not feasible for the States to repeal their payroll taxes without recourse to alternative revenue sources. One alternative recourse would arise with the broadening of the GST base and increase of the GST rate. This would simplify the overall tax system.

At the very least, The Tax Institute considers that sweeping measures are required to further harmonise payroll tax laws across the nation. This would make it easier for employers to comply with the rules and ensure the States and Territories can maintain adequate revenue streams. Serious consideration should be given to harmonising the administration of payroll tax across jurisdictions. This would eliminate the inefficiencies that arise from different interpretations and the application of an only partly harmonised system.

Responses to Board of Taxation reports and unenacted announced tax measures

The Tax Institute submits that there are additional areas which merit the Government's immediate attention. There have been a number of reviews conducted by the Board of Taxation to which the Government has not yet provided a response. Recent examples include:

- *Reforming Individual Tax Residency Rules: A Model for Modernisation* — completed March 2019;
- *Introducing Asset Merger Rollover Relief* — completed February 2017;
- *Review of the Income Tax Treatment of Certain Forms of Deferred Consideration* — completed September 2018; and;
- *Review of the Tax Practitioners Board* — completed September 2018.

On 12 December 2019, the Minister for Housing and Assistant Treasurer, the Hon Michael Sukkar, stated in a media release that the Government will consider the implications of the Board's findings in these reports.³ The Tax Institute calls on the Government to:

- (a) provide a response to these reviews and others undertaken by the Board of Taxation; and
- (b) clarify the recommendations that the Government accepts, and the steps that will be taken to implement them.

We also wish to bring to the Government's attention ongoing concerns in relation to the taxation of personal services income (**PSI**), which were raised in a report published by the Board of Taxation in 2009.⁴ In consultation with the tax profession and other stakeholders, the Board of Taxation found that the alienation of PSI regime had only in part achieved the underlying policy objective of improving integrity and equity in the tax system. In December 2009, the then Assistant Treasurer indicated that the Government would await the final report of the Henry Review before taking action.

³ <https://ministers.treasury.gov.au/ministers/michael-sukkar-2019/media-releases/board-taxation-review-cgt-rollover-provisions>

⁴ Post-Implementation Review into the Alienation of Personal Services Income Rules:
https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2015/07/PIR_Alienation_PSI_Rules.pdf

The PSI rules continue to cause confusion among taxpayers and their advisers, and questions arise as to the level of compliance with, and enforcement of, the PSI rules. A recent Full Federal Court decision⁵ highlights the continuing complexity of the rules. There should be a reconsideration as to the effectiveness of the current regime and whether it achieves the policy objective.

Further, we call on the Government to state its intentions in relation to announced, but as yet unenacted, tax measures. There are currently over 80 tax measures which have been announced but remain without legal effect. Many of these changes have already been the subject of consultation and are designed to cut red tape and make the system easier for businesses to operate. Such proposals cover a wide range of matters but include improvements to the Taxation of Financial Arrangements and measures to make Australia a more attractive destination for investment. Taxpayers require certainty in carrying on business and managing their tax affairs. The Tax Institute requests that the Government clarify which announced measures will proceed to legislation and the timeline and effective date for such measures. The Tax Institute welcomes the opportunity to further engage with the Government and consult on such measures.

Instant asset write-off

On 9 June 2020, the Government announced a six-month extension of the \$150,000 instant asset write-off (**IAWO**) from the previously legislated deadline of 30 June 2020 to 31 December 2020. To qualify for the IAWO, the asset must have been both acquired and installed ready for use by 31 December 2020. This measure will support a significant number of Australian businesses, particularly those facing supply chain issues and financial difficulties as a result of the COVID-19 pandemic, by allowing additional time for the acquisition and installation of qualifying assets.

The IAWO has been extended four times since the IAWO threshold was increased from \$1,000 to \$20,000 on 12 May 2015 until 30 June 2017⁶. The threshold has also been increased four times since 2015. This evidences the popularity of the measure at both a government and taxpayer level. The IAWO threshold is due to revert to \$1,000 for small business entities⁷ from 1 January 2021.

The Tax Institute considers that further amendments to make the IAWO a permanent feature of the tax system would bring about efficiencies and reduce the compliance burden for a vast number of taxpayers. The Tax Institute envisages that such an amendment would allow businesses with an aggregated turnover of less than \$50 million to access an ongoing IAWO for assets costing less than \$30,000. This reflects the cap for small- and medium-sized businesses before the COVID-19 pandemic arose.

Such a measure would be welcomed by eligible businesses as it would relieve them of the need to depreciate the cost of an asset over its effective life and provide a deduction that mirrors the cash flow outlay. Not only would this reduce compliance costs for taxpayers, it would relieve the Government of the need to regularly amend the tax law to give effect to a measure that is intended as an IAWO.

Corporate tax residency

The Commissioner's position is set out in Taxation Ruling *TR 2018/5 Income tax: central management and control test of residency* and Practical Compliance Guideline *PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located*.

⁵ *Commissioner of Taxation v Fortunatow* [2020] FCAFC 139

⁶ The IAWO was extended for small business entities from 30 June 2017 to 30 June 2018, then to 30 June 2019 when it was also extended to medium-sized businesses (with an aggregated turnover of less than \$50 million), then to 30 June 2020 when it was also extended to larger businesses (with an aggregated turnover of less than \$500 million), then most recently to 31 December 2020.

⁷ Aggregated turnover of less than \$10 million.

The Tax Institute considers that this uncertainty cannot be resolved by further guidance material. The Tax Institute considers that a legislative solution is required to resolve the uncertainty. Further, The Tax Institute considers that the best option for resolving this uncertainty is to modify the central management and control (**CMAC**) test to ensure that having CMAC in Australia cannot, by itself, be taken to also constitute carrying on business in Australia for tax residency purposes. That is, a modification which legislatively reinstates the position as set out in former tax ruling TR 2004/15 where the residency test was applied in two steps.

Addressing the uncertainty in this manner will also provide the opportunity for the definition of corporate tax residency to take into account the realities of modern business. Removing this obstacle and providing certainty to businesses will be important in the coming years as businesses attempt to recover from the impacts of the COVID-19 pandemic.

The Government should release the Board of Taxation's report on corporate residency and announce its response to reduce the uncertainty referred to above.

Superannuation guarantee amnesty extension and Commissioner's discretion on penalties

The Tax Institute wishes to take this opportunity to again call on the Government to extend the superannuation guarantee (**SG**) amnesty, which is due to expire on 7 September 2020, by six months to 7 March 2021. The COVID-19 pandemic has caused widespread disruptions to businesses, including a significant downturn in activities, unexpected office and premises closures, and disruptions to usual practices. These disruptions have affected a large number of employers, many of whom may wish to make disclosures under the amnesty but have had to redirect their resources to other priorities such as keeping their businesses afloat through the pandemic. Further, financial strain and cash flow issues caused by such disruptions mean that businesses may not have immediately available funds to pay superannuation guarantee shortfalls, and the Victorian Stage 4 restrictions are preventing access to vital payroll records and documents⁸ which are necessary to determine the amount of any SG shortfalls.

Under the amnesty, eligible employers may disclose and pay unpaid SG shortfalls without penalty and may claim a tax deduction. However, once the amnesty expires, the repercussions for a failure to come forward and disclose historical non-compliance can be severe. The current rules discourage employers who are trying to do the right thing from admitting honest mistakes. Even minor errors, such as paying superannuation just one day late, are met with disproportionately onerous and draconian penalties. The severity of the Part 7 penalty alone has the capacity to drive businesses to insolvency, and directors' personal liability is a further risk.

The Tax Institute again calls on the Government to grant the Commissioner the discretion to reduce the Part 7 penalty imposed at the rate of 200% to nil after the current amnesty deadline. The current law restricts the Commissioner from remitting penalties below 100% of the amount of the SG charge payable for employers who fail to disclose shortfalls during the amnesty period. We consider that this discretion should be afforded to the Commissioner, especially in the event that the amnesty is not extended, as a large number of employers will not be able to meet the deadline due to the effects of the COVID-19 pandemic.

We request that the Government take into consideration the competing challenges currently facing Australian businesses as a result of the COVID-19 pandemic, and not only extend the amnesty for a minimum of six months but also provide the Commissioner of Taxation with the discretion to reduce the 200% Part 7 penalty to nil.

⁸ Given the amnesty is available for quarters stretching back to 1 July 1992, many of the necessary payroll records and documents will be archived or in storage at inaccessible business premises or third-party storage areas.

We request that the Government take into consideration the competing challenges currently facing Australian businesses as a result of the COVID-19 pandemic, and not only extend the amnesty for a minimum of six months but also provide the Commissioner of Taxation with the discretion to reduce the 200% Part 7 penalty to nil.

The black economy and tax avoidance

The black economy refers to people and organisations who operate outside the tax and regulatory systems, or who do not comply with their tax reporting obligations. Black economy activities include bookkeeping understatements, undeclared income derived from the sharing economy, phoenixing and serious illegal activities such as money laundering and drug trafficking. In the Black Economy Taskforce's Final Report, the black economy in Australia was estimated to be worth \$50 billion per year and continually changing and expanding.

Engaging in activities through the black economy undermines the integrity of the tax system. The black economy also affects other fundamental areas of Australian life including workplace relations, and financial and welfare systems, each of which are inextricably linked to the tax system. It penalises honest taxpayers and creates an uneven playing field for businesses, putting small businesses in particular at an unfair disadvantage.

In May 2018, in response to the recommendations of the Black Economy Taskforce's Final Report, the Government announced a whole-of-government package for tackling the black economy which included a series of measures announced in the 2018-19 Federal Budget. While some such announcements have been given effect, there is still plenty of work to be done to overcome the ongoing challenges caused by the black economy. We urge the Government to take further action to redress the adverse effect of the black economy on the Australian tax and welfare system. This may be achieved through a combination of reducing the many compliance burdens associated with tax reporting obligations, and on a broader scale, providing greater public education and engagement opportunities to address the shifting cultural views on black economy activities and shape taxpayer behaviour.

APPENDIX C

The Tax Institute's Pre-Budget Submission dated 23 October 2019



Tax Institute
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