CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

12 June 2015

Mr Roger Brake
Secretary
Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Roger

## Submission on Re:think Tax Discussion Paper, March 2015

Thank you for the opportunity to comment on the Tax Discussion Paper (TDP).

In view of the broad nature of the questions posed in the TDP and the short timeframe for comments, our submission examines some (not all) of the issues at a high level rather than delving into detail. Some parts of our submission reflect what we said previously to the Henry Tax Review and in other submissions to the Board of Taxation, Inspector General of Taxation, Treasury and the Australian Taxation Office.

We understand that more comments will be sought by the Government when it issues the Green Paper expected later this year.

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## The tax reform process

At the outset, we sense there is a level of frustration and disappointment amongst our members at the way in which the tax reform process has been managed at a political level to date.

It seems to many that what we are really dealing with here is the politics of the achievable.

Several reform topics appear to have been 'ruled out' by senior Government Ministers from the outset with little justification for the stance adopted.

In addition, any changes to the GST rate and base have been portrayed as requiring the endorsement of all State and Territory leaders without any apparent evidence of a genuine attempt at a national 'Re:think' strategy.

From a policy perspective, this rule-in, rule-out approach has made it difficult for the community to gauge whether our tax system is being examined as a whole, and determine how it can be redesigned to promote economic growth and support the future provision of government services.

Changing the tax mix will involve winners and losers. It may also involve some taxes increasing (in either scope or rate) and other taxes decreasing or being eliminated altogether. Considering each tax policy change in isolation could result in policy stagnation as individual policy changes are perceived to be either inequitable or unaffordable.

Our comments are not just directed to the Coalition Government: we are also concerned with the tax policy positioning of the Australian Labor Party, Australian Greens and other political groups. Each will need to prepare their tax policies carefully in the lead-up to the next Federal Election. Already, there is a perception being generated that all will be well with our tax system if we simply target the tax avoidance strategies of large multinational companies and certain features of the superannuation tax system considered to be skewed towards high wealth individuals. Although these are indeed tax policy areas which should be reviewed, much broader policy thinking is required if we are to meet future challenges.

Our fear therefore is that a bipartisan political approach on major tax reforms is looking increasingly unlikely, notwithstanding the many burning bridge issues identified in the 2015 Intergenerational Report and declining tax revenues from the mining sector.

In some quarters, our comments about the politics of tax reform will no doubt be seen as naïve.

There are some in our community whose voting decisions are driven solely by self-interest and there will no doubt be groups campaigning vigorously for or against particular reform proposals come the next Federal Election. And we are all too well aware of the difficulties encountered in progressing legislative change through a Senate rarely controlled by the government of the day.

In terms of the economic environment, we also acknowledge the current budget difficulties and the need to maintain confidence in the business community and amongst many of our citizens who feel they are not getting ahead in a financial sense. Tax reform is easier in more robust economic times.

But with few options left in terms of monetary policy, and the government's difficulty in implementing fiscal policy, tax reform is an important opportunity to provide a much needed boost to the economy.

Hopefully, an increasing number of Australians understand that our current tax system will not sustain the government services we have come to expect. If so, this will be due in no small part to the government's recent community education campaign and the thought leadership of many organisations, including ours, on tax reform issues.

We think more needs to be done however to convey key messages about our tax system and the Green Paper provides the next important opportunity.

We urge the government to stay the distance on tax reform and hope that our submission both illustrates our support and provides useful insights.

## The need for an on-going focus on tax reform – A Tax Reform Commission

In light of the abovementioned difficulties associated with tax reform and the need for bipartisan support, we recommend the establishment of an independent body – such as a Tax Reform Commission – which can look past the electoral cycle and develop long term, truly nation-building approaches to tax reform at both Federal and State level.

It could be that the current Board of Taxation provides the foundation for such an organisation, although it currently lacks a mandate from the State and Territories to undertake reviews dealing with the taxes levied in those jurisdictions and the local government tax base. The membership of the Board and the specialist skills available to it would also need to be considerably bolstered.

As part of our commitment to such a body, Chartered Accountants Australia and New Zealand would be prepared to fund the appointment of an experienced, knowledgeable tax researcher to such an organisation for an agreed period.

## Achieving tax reform as a long term plan

Tax reform has come to be seen by the Australian community as something which has been over-promised and under-delivered.

Rightly or wrongly, the expectation created by both the Henry Tax Review and the current Re:think process is that major changes will occur, some of which will immediately be detrimental to certain segments of the community.

Little consideration appears to have been given to a tax reform roadmap which is announced up-front, but implemented as part of a staged adjustment process according to a published plan allowing citizens and businesses time to adapt.

For example, we see a need for a roadmap for Australia's corporate tax rate to be lowered as part of a long term strategy to make our economy more globally competitive, boost investment and create jobs. The United Kingdom provides a model in this regard.

Similarly, GST has become almost a total 'no-go' zone in Australian political discourse at a time when other countries have realised the importance of increased reliance on broad-based consumption taxes and managed the expectations of their population that such changes need to occur. We need to plan how this revenue base could grow to meet future needs.

## Tax administration is changing: complementary tax policy changes are needed too

In contrast to what could turn out to be a lack of direction at a policy level, the Australian Taxation Office (ATO) has embarked on an ambitious modernisation process (Reinventing the ATO) to change the way it administers our Federal tax laws. This is possible because the Commissioner of Taxation is empowered by statute with a general power to administer the various tax laws for which he is responsible.

In particular, the ATO is embracing 'digital by default' approaches and is expected to take a lead role in the work of the recently established Digital Transformation Office.

Whilst we welcome these efforts, policy and administrative reform should ideally be undertaken in tandem. For example, the ATO may be keen to streamline procedures for the reporting and payment of employer PAYG withholding and Superannuation Guarantee obligations (the Single Touch Payroll proposals), but to achieve true efficiencies, the relevant law on which such obligations are based must be reformed.

The ATO cannot be expected to build a more modern, streamlined tax administration system on outdated tax legislation and policy concepts. If it goes too far down the track in attempting to do so, there is a real risk that the Commissioner's efforts will be portrayed as adding to, not reducing, red tape.

## Detailed submission

Our comments on many of the questions posed in the TDP accompany this letter.

We have noted in conversations with Treasury officials your request for evidence-based submissions, with the support of hard data. We have taken the reference to hard data to include feedback from Chartered Accountants working at the coalface with clients and in business.

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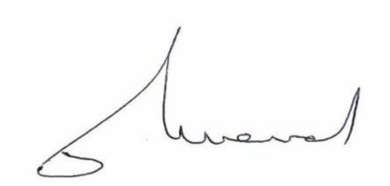
We would be happy to discuss any aspects of our submission with you.

For that part of the submission dealing with superannuation matters, contact Ms Liz Westover (Superannuation Leader) on (02) 9290 5704 or liz.westover@charteredaccountantsanz.com

To discuss any other aspect of our submission, please liaise with Mr Michael Croker (Tax Australia Leader) on (02) 9290 5609 or michael.croker@charteredaccountantsanz.com

Yours faithfully,



**Rob Ward**
**Head of Leadership & Advocacy**

# Submission on Re:think Tax Discussion Paper

## March 2015

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# 1: Challenges for Australia's tax system

**Our submission comments below on the following discussion question in the TDP:**

1. Can we address the challenges that our tax system faces by refining our current tax system? Alternatively, is more fundamental change required, and what might this look like?

We see the tax system as a key factor in addressing the challenges ahead for Australia. These challenges have been well considered in the 2015 Intergenerational Report and the TDP itself. Much of the thought leadership shown by the Henry Tax Review is as relevant today as it was in 2010.

As for other areas in which fundamental change is required, we note the many worthwhile reviews and reports which have been commissioned by this and previous governments on various topics of national importance, as well some of the recent policies which have been implemented. These topic areas include:

- Education reform which equips all young Australians with the skills needed in a modern, service based economy
- Enhancing productivity
- Encouraging greater workforce participation (especially from working mothers and senior citizens)
- Continued efforts to remove trade barriers with major trading partners, enabling Australia to play to our key strengths in fields outside the minerals and extractive industries
- Infrastructure project spending on areas of key need
- Climate change policies which make a real difference, and
- Reconsideration of the size and role of government, both State and Federal.

This last point - which impacts the very 'social contract' that links Australians with each other and their government and challenges our individual views of a just and equitable society, of acceptable social, economic and legal norms – is key. If we cannot address issues such as public spending in key areas and remove duplication of service delivery, no tax base will ever be enough to support the needs of government.

For further commentary, reference should be made to our *Future*[inc] series of thought leadership papers[1].

The comments below relate solely to tax reform.

## 1.1 Strong leadership in a strong Federation

Fundamentally, good public policy is about leadership: leadership of vision, leadership of thinking, and leadership of communication.

Both the 2015 Intergenerational Report and the TDP clearly indicate that the tax reform framework must be strengthened in order to appropriately deal with the economic and social challenges of the next few decades. The Federalism White Paper process highlights the important role that States and Territories must also play.

[1] Refer CA ANZ website: http://www.charteredaccountants.com.au/futureinc

Frankly, there is much skepticism amongst our members about whether our nation's leaders are willing to embark upon a major shift in the way our political institutions collaborate, in terms of areas of responsibility, spending and funding.

## 1.2 Community awareness and support still needed

Tax reform is an area where evidence-based public policy decision making is crucial.

Yet tax touches most citizens, and all of us naturally gauge the impact of new policies in personal financial terms. It is difficult (to say the least) for Australians to look beyond this immediate impact to the broader picture, particularly where there is a large gap between the political stance of the major parties.

We also note growing concern about inequality in our society, and even amongst those who are employed there is a feeling that fewer and fewer of us are 'getting ahead'. Technology change – the so-called Second Machine Age – is also increasing skepticism that increased business investment and jobs growth which would normally flow from tax reforms such as a reduced company tax rate will occur.

Effective communication about the need for tax reform and the expected outcomes is therefore far more critical now than it was in the past. A fast pace of change, together with the 'round the clock' news cycle, has made the policymaking process an exercise in public relations as much as in effective decision making.

We therefore acknowledge and applaud the work done by the government to date in seeking to educate the community.

Our sense however is that there are still many Australians unaware of the need to have a more sustainable tax base. For those that are aware, some may feel that the problems can be addressed by solely targeting particular groups such as wealthy individuals and large companies. There may indeed be well-founded policies targeted at these taxpayer segments, but it would be incorrect to assume that this is all that is required.

## 1.3 A guiding, non-political Tax Reform Commission

To help guide the process therefore, we believe that the tax reform focus should be redirected in part towards a stronger and more collaborative public policy-making organisation which can out-last the political cycle and formulate, on a project by project basis, tax policy on a range of key policy areas.

This organisation – a "Tax Reform Commission" – would be directed by a tax reform roadmap developed by the Federal, State and Territory Governments from the current tax reform and Federalism processes. It would bring together public and private sector experts to work on a project basis.

It could be that the current Board of Taxation provides a foundation for such a body, although it currently lacks a mandate from the State and Territories to undertake reviews dealing with the taxes levied in those jurisdictions. The membership of the Board and the specialist skills available to it would also need to be considerably bolstered.

The Green Paper should:

- Set out in broad terms the nature of the reforms proposed by the Government and the rationale for those reforms. This would become the Government's tax reform roadmap for the next term of office, should it be re-elected. For the Opposition parties, it would be the basis for developing a counter-model to take to the next Federal Election.

- Propose the establishment of a Tax Reform Commission to guide the future tax reform process. Apart from undertaking research and making recommendations, it would also engage in design, development and implementation tasks 'to see the job through'. The current Board of Taxation may form the basis for this organisation, although it would have a much broader remit and would need to be resourced accordingly with the added support of State and Territory governments.

# 2: Australia's tax system

**Our submission comments below on the following discussion questions in the TDP:**

2. How well does Australia's utilisation of its available taxes align with the evolving structure of Australia's economy and changes in the international economy?
3. How important is it to reform taxes to boost economic growth? What trade-offs need to be considered?
4. To what extent should reducing complexity be a priority for tax reform?
5. What parts of the tax system are most important for maintaining fairness in the tax system? Are there areas where fairness in the tax system could be improved?

## 2.1 Towards a greater reliance on indirect taxation, withholding and data reporting

Well designed and implemented with due regard to the obligations imposed on business, we believe that a greater reliance on indirect taxes and withholding taxes can reduce complexity for the broader Australian community.

We regard an expanded GST rate and base as a fundamental reform which is in the long-term interests of Australia.

The internationalisation of business is making it harder to apply income tax concepts designed for earlier times in our economic history. Whilst we support moves for multi-lateral changes to international tax laws to address BEPS, the competition for global capital remains and Australia, as a comparatively small open economy, must maintain policies which make it attractive for foreign capital to be invested here.

Also, effective tax systems are increasingly founded on data collection and analysis. Greater reliance on reporting and withholding goes hand in hand with such technology as tax agencies all around the world are challenged by governments to achieve more with less funding and staff resourcing.

## 2.2 The importance of corporate tax reform

As we said in our submission to the Henry Tax Review, Australia's corporate tax sector is a key contributor to the capital taxation base and a key driver of growth in our economy. The extent to which the corporate sector is taxed and how such tax is imposed are critical issues in shaping Australia's future.

Australia has an over reliance on corporate taxation and the current corporate tax burden is uncompetitive when compared to other countries, both from an OECD and regional perspective.

The tax inversion problem which has recently beset the United States of America also shows that some types of companies – particularly those engaged in the provision of services, or which profit from highly valuable intellectual property – have a choice where to locate their tax domicile and are willing to move away from high tax jurisdictions.

In much the same way as the United Kingdom did in its 2010 Budget, the Green Paper should commit to an aspirational goal of reducing the general corporate tax rate from 30% to 20%, with a 25% rate (as recommended by the Henry Tax Review) as an interim target.

This reform must obviously be considered against a range of potentially competing reforms, and as noted in this submission, we are open to a number of changes to company taxation. The immediate revenue cost however needs to be considered in the context of the longer term investment, economic and revenue benefits. Further Treasury modelling on this aspect would be welcome.

# 3: Individuals

**Our submission comments below on the following discussion question in the TDP:**

6. What should our individuals income tax system look like and why?

## 3.1 Key features of a good individual income tax system

Chartered Accountants Australia and New Zealand believes that the key features of our individual income tax system should be as broadly identified in the Henry Tax Review:

- The income tax law applicable to resident individuals (as distinct from other taxpayer categories) should be as simple as possible, particularly if Australia is to move to a system which does not require income tax returns to be lodged by those with straightforward tax affairs (or a system which encourages lodgment online using myTax).
- A constant marginal rate for the vast majority of individuals should apply to provide greater transparency and simplicity[2] (especially to combat the effects of bracket-creep). Ideally, this rate should match the general corporate tax rate but that now seems an unlikely outcome given the general trend worldwide to lower the rate of company tax.
- Eligibility and delivery of personal entitlements should occur through the transfer payment system[3], administered by a central agency other than the ATO.
- A standard deduction should apply to work-related expenses on an opt-in basis[4]. Those who have more complex or larger deduction claims should be entitled to the existing general deduction principles in section 8-1 ITAA 1997[5] and comply with substantiation requirements.
- Consideration should be given to a 40% savings income discount to individuals with non-business related income[6].

Rather than changing established principles underpinning the deductibility of expenses[7], we support the standard deduction framework suggested in the Henry Tax Review[8].

As for levies such as Medicare, we tend to agree with comments from the Mirrlees Review that a good tax system should be structured to meet overall spending needs, and that:

> "…earmarking of revenues that does not impose a binding constraint on spending is empty rhetoric: 'an exercise in deceiving voters that their tax payments [control] government spending in a way which they simply will not…misleading taxpayers rather than expanding democracy'. (Quoting from Institute for Fiscal Studies, 1993, pp. 64–5)[9]

[2] Henry Tax Review 2009, Recommendation 2.
[3] Henry Tax Review 2009, Recommendations 3 to 6.
[4] Henry Tax Review 2009. Recommendation 11.
[5] Contrary to Recommendation 12, Henry Tax Review 2009. We cannot see why individuals with more complex tax affairs are less deserving of established deduction principles such as nexus and apportionment.
[6] Henry Tax Review 2009. Recommendation 14.
[7] Henry Tax Review 2009. Recommendation 12. See reference to a tighter nexus approach.
[8] Henry Tax Review 2009, Recommendation 11.
[9] *The Mirrlees Review: Conclusions and Recommendations for Reform*, James Mirrlees et al, Fiscal Studies, vol. 32, no. 3, pp. 331–359 (2011).

## 3.2 Removing the income tax compliance burden from individuals with straightforward tax affairs

CA ANZ has long advocated an opt-in, simpler, almost compliance free system of taxation for individual taxpayers with straightforward tax affairs.

Our thinking on this envisages an individual tax system in which:

- PAYG withholding tax is (by making better use of ATO data and available technology) more accurately calculated and withheld at source, using electronic communication with employers whose payroll systems are aligned to ATO systems.
- Work-related deductions are replaced by standard allowances, with those taxpayers seeking higher deductions obliged to comply with rigorous substantiation rules and lodge details with the ATO.
- A small amount of capital gains could be treated as exempt.
- Donations above a specified dollar threshold (the Henry Tax Review suggested $25[10]) are data matched with the charities which received them.
- All personal tax offsets are repealed and replaced with direct transfer payments to those who meet the eligibility criteria.

For most individuals, their main obligation would be advise the ATO (and other government agencies) of specified changes in circumstances, such as a change from employee to self-employed status. Special purpose, 'short' tax returns would be required for isolated transactions such as CGT on the disposal of an investment property or parcel of shares.

Other countries such as the United Kingdom and New Zealand have managed to implement 'no tax return' systems.

Currently, Australia has a myTax system which on the one hand is touted as a compliance reduction measure, and yet is accompanied by annual tax time warnings from the ATO about substantiation requirements and the over-claiming of deductions.

Why only go half way towards a goal other countries have managed to achieve using readily available technology?

This is an example of an area of taxation in which the Commissioner can only go so far. He needs support from policy makers to achieve genuine savings in revenue collection costs.

The Green Paper should put forward a model for individual taxpayers with straightforward income tax affairs to choose to be removed from the requirement to lodge an annual income tax return.

CA ANZ would be happy to work with Treasury officials on the design of such a model.

[10] Henry Tax Review, 2010. Recommendation 13.

**Our submission comments below on the following discussion question in the TDP:**
7. What should our fringe benefits tax system look like and why?

## 3.3 Fringe Benefits Tax

As noted in the TDP, the taxation of fringe benefits is integral to the fairness of our tax system.

Chartered Accountants hear many complaints from employers about the complexity and compliance requirements of FBT:

- FBT over taxes benefits (vis-à-vis the employee's personal marginal rate).
- Being a drag-net tax, the design of FBT wrongly assumes that every benefit provided by an employer to an employee confers something of value from the employee's perspective and hence there are numerous exemptions, some with overly onerous eligibility criteria.
- It fails to acknowledge that many businesses simply do not package benefits nor provide private benefits (apart from the occasional minor, exempt benefit such as an annual staff Christmas party, employee wedding gift etc.).
- The non-alignment of the FBT year with the income tax year sometimes causes errors and confusion.
- The reportable fringe benefit concept, based on selective data for a period not aligned to the income year, is frustrating attempts to streamline employer reporting (eg the single touch payroll project) and employee data collection.

We believe that FBT should be repealed and replaced by income taxation (PAYG withholding) of employee benefits. This has been our stance since 2006[11], and partly reflects Recommendation 9 of the Henry Tax Review. Unlike the Henry Tax Review however, we believe it is possible to repeal the tax entirely.

We appreciate that this reform will require careful design in order to address the integrity aspects referred to in the TDP, but aspects of the new approach could include:

- Simple valuation rules for the main benefit categories which can be readily valued and attributed to an employee (cars, loans, living away from home allowances, private use property and services)
- Thresholds for the tax free provision of minor \ infrequent benefits and discounted in-house employee goods and services
- An ability for employers to make "no salary packaging - no private benefit" declarations (especially for expense payments and entertainment), effectively stating to the ATO that the employer's policy is not to provide private benefits to employees, and
- Clear criteria for exempt benefits, developed using common sense business and human resource (rather than tax) concepts.

For those concerned that this leads to a return to tax effective packaging of benefits such as entertainment, we think it possible to design mechanisms which would see employees deemed to have received the benefit of any tax arbitrage which would otherwise result from

[11] CA ANZ website: http://www.charteredaccountants.com.au/Industry-Topics/Tax/Publications-and-tools-NEW/Publications-and-tools/Fringe-Benefit-Tax-Design

differences between the employer's company tax rate, and the employee's top marginal rate (or the employer's GST input tax credit status).

Safeguards could also be designed in the income tax law (eg for situations where an employer provides excessive levels of entertainment in circumstances where the value cannot be attributed to particular employees). For tax exempt employers, excessive entertainment spending could impact funding eligibility or tax exempt status.

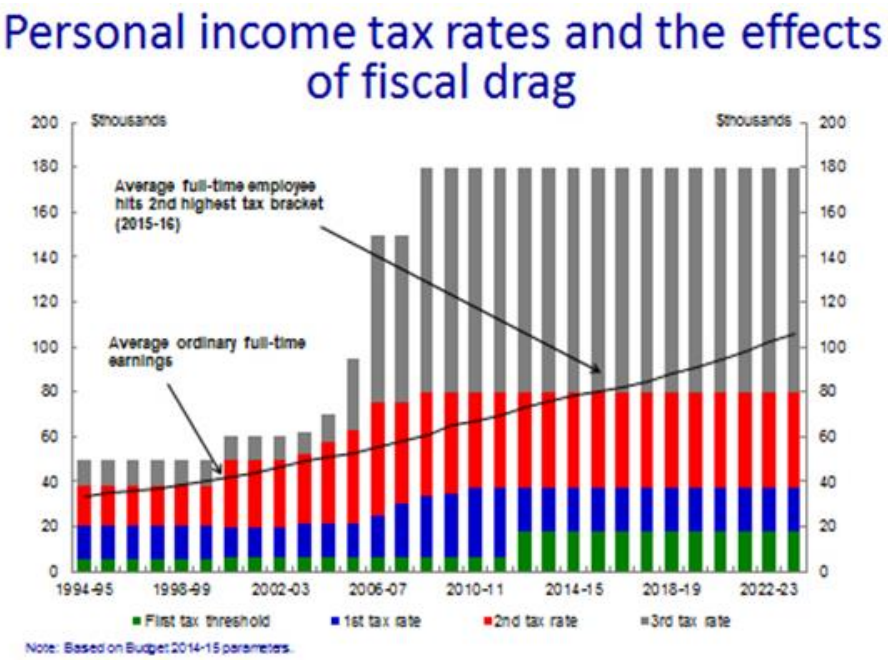
> The Green Paper should put forward a model for the repeal of FBT, with the value of key benefits included in the PAYG withholding regime.
>
> CA ANZ would be happy to work with Treasury officials on the design of safeguards which address tax arbitrage effects resulting from discrepancies between employer and employee tax rates, and the employer's GST input tax credit entitlements.

**Our submission comments below on the following discussion question in the TDP:**

8. At what levels of income is it most important to deliver tax cuts and why?
9. To what extent does taxation affect people's workforce participation decisions?
10. To what extent are the interactions between the tax and transfer system straightforward for the people who deal with both systems?

## 3.4 Personal tax cuts

Australian revenue forecasts are relying heavily on bracket creep to generate revenue. Treasury has repeatedly warned that this "fiscal drag will pull someone on average full time earnings into the 37% tax bracket from 2015-16, and will increase the average tax rate faced by a taxpayer earning the projected average from 23% to 28% by 2023-24 — an increase in their tax burden of around a fifth"[12]. This is illustrated by the chart below.




[12] The 2014-15 Budget and Sustaining Broad Based Growth in Living Standards, Speech to the Australian Business Economists, Dr Martin Parkinson, 20 May 2014.

The increasing discrepancy between the corporate tax rate and the individual tax rate also encourages people to participate in tax planning. This increases complexity and to some extent discourages compliance with the tax system (e.g. through the alienation of personal services income to personal service entities).

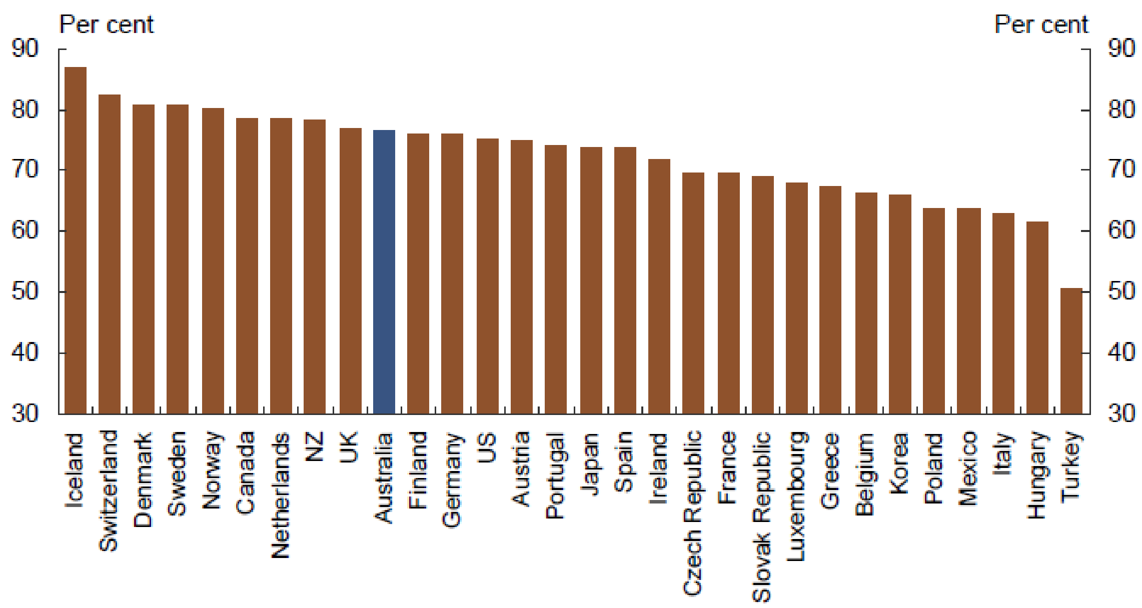
It is also argued that higher marginal tax rates discourages people from participating in the economy. Given that Australia has a highly trained female workforce and an aging population, this is concerning.

For example, the 2015 Intergeneration Report at page viii states that[13]:

> *"There will be fewer people of traditional working age compared with the very young and the elderly. This trend is already visible, with the number of people aged between 15 and 64 for every person aged 65 and over having fallen from 7.3 people in 1974-75 to an estimated 4.5 people today. By 2054-55, this is projected to nearly halve again to 2.7 people."*

Overall, Australia's participation rates are relatively good (refer to chart 5 of IGR 2010 reproduced below which shows Australia's participation rate in comparison to OECD participation rates).

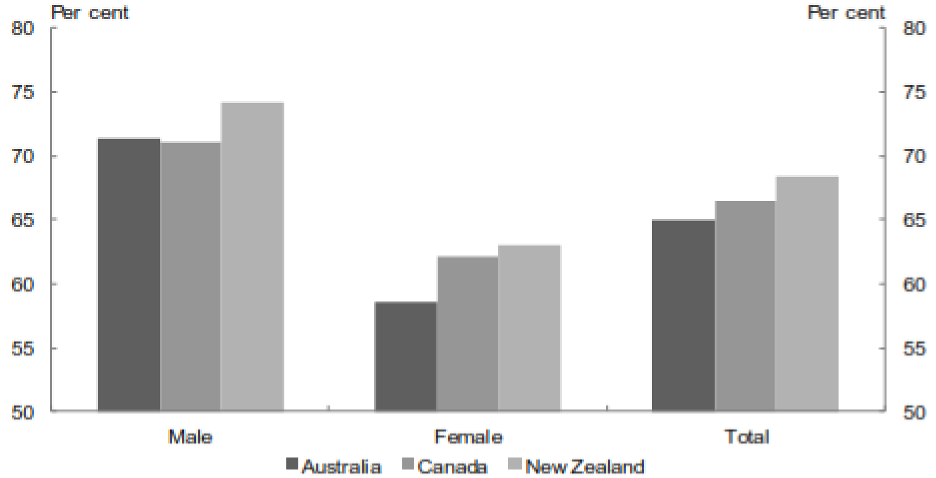
**Chart 5 IGR 2010 - OECD participation rates 2008, people aged 15-64[14]**




However there is room for improvement, particularly in relation to women (refer to chart 1.15 of IGR 2015 below[15]).

[13] 2015 IGR Report, page viii: http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/2015-Intergenerational-Report
[14] 2010 IGR Report: http://archive.treasury.gov.au/igr/igr2010/report/pdf/IGR_2010.pdf
[15] http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/2015-Intergenerational-Report

Chart 1.15 International comparison of participation rates, 2013




Source: International Labour Organisation.

As noted in the 2015 Intergenerational Report:

> *"By 2054-55, the participation rate for Australians aged 15 years and over is projected to fall to 62.4 per cent in 2054-55, compared with 64.6 per cent in 2014-15. That said, female employment is projected to continue to increase, following on from strong growth over the past 40 years. In 1975, only 46 per cent of women aged 15 to 64 had a job. Today around 66 per cent of women aged 15 to 64 are employed. By 2054-55, female employment is projected to increase to around 70 per cent.*
>
> *Nonetheless, Australia's female participation rates remain lower than some other advanced economies such as Canada and New Zealand, and more can be done to encourage women to enter and stay in the workforce. Policies that help to continue to boost female participation will help Australia achieve an even higher level of future prosperity."*

Whether tax rates affect participation has been the subject of several studies in Australia.

These studies have found that elasticity of labour supply of existing workers is low, around 0.71[16]. This is speculated to be the result of workers having preferences for the type of work that they do and where, and to the cost of changing jobs.

Other studies have shown that the labour supply of those on high incomes is largely unresponsive to tax rate changes. The reasons why are not completely clear but include the suggestion that such people are motivated by the type of work they undertake rather than cash, and they may have the ability to reduce the impact of higher income tax by undertaking tax planning.

Various studies of effective marginal tax rates that take into account the interaction of the transfer and tax systems indicate that various segments of the Australian population face effective marginal tax rates (often in excess of 60%) which are higher than the top marginal tax rate. In particular, it has been noted that "A major lesson of the last 20 years is that the strongest empirical effects of wages and non-labour income on labour supply are to be found at ... the margin of entry and exit."[17] (Heckman 1993, p. 117).

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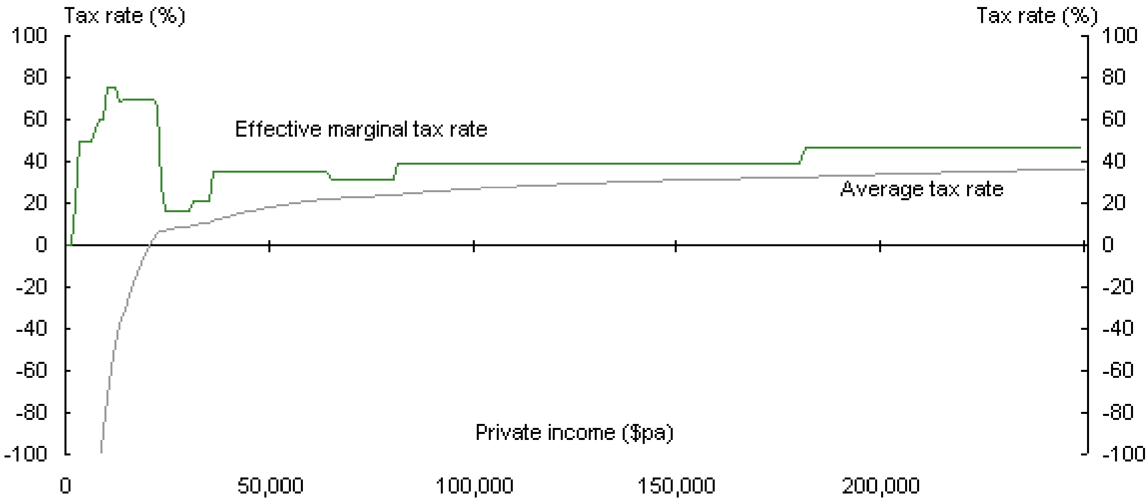
[16] A. Booth and P. Katic, *Estimating the wage elasticity of labour supply to a firm: is there monopsony down under?* Discussion Paper DP6, The ANU Centre for Economic Policy Research, 26 December 2009.

[17] Heckman 1993, p. 117. Source: http://lateraleconomics.com.au/wp-content/uploads/2014/02/CEDA-Tax-Cuts-for-Growth.pdf

This is illustrated in the chart below, taken from the Henry Review.

## Chart A1–7: Increasing average tax rate for a single person without children, 2009–10




Source: Treasury estimates.

Overall, this data suggests that:

- It is important for personal tax rate relief to be targeted at the sizeable proportion of Australians who are currently in the 32.5% rate band ($37,001 to $80,000) – this rate excludes the 2% Medicare levy.
- There needs to be greater integration of the tax and transfer systems, including:
  - The use of consistent definitions of income.
  - Centralised access and information portals as part of an e-government strategy.
  - Online scenario planning calculators so that citizens can understand the impact of an employment opportunity or life event (e.g. retirement) on their personal financial circumstances.
- Future personal tax cuts should be focussed on providing a high tax free threshold with a simple progressive tax rate structure that incorporates (if applicable) levies and offsets.

As per the Henry Tax Review recommendation, a tax exemption should apply to income support transfer payments[18].

[18] Henry Tax Review (2009). Recommendation 4.

**Our submission comments below on the following discussion question in the TDP:**
11. How important is tax as a factor influencing people's decisions to work in other countries?

## 3.5 Tax and workforce participation – the Canadian experience

Treasury undertook research on the impact of the personal tax – transfer system during the course of the Henry Tax Review[19]. The economic and social benefits of greater workforce participation are generally well-known, and are reflected in the Government's recent child care announcements.

Participation (or labour supply) is often referred to as one of the Three P's of economic growth, along with population and productivity.

In the absence of improvement in the latter two factors, declining participation brings with it the triple dilemma of:

- Lower nominal GDP growth (thus reducing growth in tax revenue)
- Lower GST collections (due to constrained household consumption by those not in the workforce), and
- When caused by the retirement of older workers, increases in public expenditures related to caring for the aged.

Although we did not have adequate time or resources to research Question 9 fully, we chose to focus on Canada, a jurisdiction often used as a comparable to Australia in terms of cultural attitudes and institutional settings. Canada also outranks Australia in most of the measures used in surveys relating to participation, although comparison adjustments are required due to the way the two countries determine who is employed during maternity leave.

There is however a more important point of differentiation; the Canadian Government delivered a balanced budget in 2015, underpinned by a low-tax Economic Action Plan.

We note also that Canada's participation rate has recently been in decline. Like Australia, long-term demographic changes are impacting Canada. The baby-boomer generation is retiring from the workforce[20].

Nonetheless, the better participation results in Canada appear to be at least partly attributable to a number of measures, in particular[21]:

- A Family Tax Cut – a non-refundable tax credit of up to CAD $2,000 for eligible couples with children (this credit is based on the net reduction of tax that would occur if up to $50,000 of an individual's taxable income was transferred to their partner)
- A Universal Child Care Benefit which offsets the costs of whatever form of child care parents choose

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[19] Architecture of Tax and Transfer System, Section 7: The Personal Tax-Transfer System.
[20] Royal Bank of Canada, ***What explains the decline in Canada's labour force participation rate?*** Current Analysis, May 2014.
[21] Government of Canada, *Helping Families Prosper.* Source: http://www.budget.gc.ca/efp-peb/2014/overview-apercu-eng.html#taxcut

- The Working Income Tax Benefit, a refundable tax credit that benefits low-income Canadians, many of whom are women (includes a supplement for persons with disabilities)
- Child care expense deduction (allows child care expenses incurred to earn employment of business income, pursue education or perform research to be deducted, dollar limits apply depending on the child's age and whether they have disabilities)
- Child Disability Benefit, and
- Canadian Employers for Caregivers Plan.

For seniors and pensioners:

- There have been regular increases in the Age Credit amount (for Canadians aged 65 and older)
- The maximum amount of income eligible for the Pension Income Tax Credit has doubled to CAD $2,000
- Pension income splitting has been introduced, allowing eligible Canadians to split up to 50% of their pension income with their spouse to reduce the overall family tax burden, and
- The age limit for maturing pensions and Registered Retirement Savings Plans has increased from 69 to 71 years of age (in Canada, contributions to RRSPs are deductible, investment income earned in them is not taxed, and withdrawals are fully taxed).

The Canadian Economic Action Plan also, includes expanded tax relief for home care services (bathing, feeding, and other personal care) and home accessibility.

Workforce participation issues are regularly researched and reported on by the Canadian Government [22], which appears to be particularly active in the policy area.

Apart from the tax related incentives listed above, there has also been comparative research with Canada indicating that, although Australia's high tax free threshold encourages part-time work, our comparatively high marginal rates discourage those contemplating moving from part-time to full-time work (or discourages those thinking of staying in full-time work)[23].

We are not suggesting that every Canadian policy listed above is relevant or suited in an Australian context. Indeed, we think Canada resorts too much to its tax system to deliver these concessions and thereby adds complexities.

Nonetheless, our point is that the diverse range of approaches in Canada seems to cater for many of the reasons commonly cited for low participation rates, and may therefore be worthy of further consideration in an Australian context.

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[22] For example, see National Seniors Council (Canada), *Older workers at risk of withdrawing from the labour force or becoming unemployed: Employers' views on how to retain and attract older workers*, March 2013.
[23] Siobhan Austen, *A Survey of the Differences in Australian and Canadian Women's Involvement in Paid Work*, Women in Social & Economic Research, Working Paper No 48, Curtin University, November 2005.

**Our submission comments below on the following discussion questions in the TDP:**

12. To what extent is tax planning a problem in the individuals income tax system? Are existing integrity measures appropriate?
13. What creates incentives for tax planning in the individuals income tax system? What could be done about these things?

## 3.6 Tax planning in the individuals tax system

For employees, the income tax system offers few opportunities for tax planning relating to their employment arrangements. Salary sacrificed superannuation and exempt fringe benefits (eg laptops) are perhaps the most popular strategy for those who can afford to go without after tax cash in hand.

Company cars are also attractive for some, typically high income employees because of the FBT calculation method on the car benefit and the ability to pay for car running costs in pre-tax dollars without FBT. Under our preferred model (see above), car benefits and associated running costs would be valued and included in the employee's assessable income.

For self-employed individuals, there are more tax planning opportunities available (eg legitimate business expenditure is deductible and business-only tax concessions are available). There is a distinct trend towards self-employed, contractor status within the Australian community, driven in part by changing work arrangements and a desire by employers to avoid the on-costs and administration associated with hiring employees.

The personal services income provisions in the income tax law seek to discourage those who want to artificially avoid employee status or divert personal income to associated entities. But well-advised taxpayers can generally structure their arrangements so as not to fall foul of these provisions.

As we said in our submission to the Board of Taxation's Review into Tax Impediments Facing Small Business, we think that:

- The existing personal services income law could be simplified, and
- Using technology and data analysis, follow-up tests could be developed to determine whether start up personal service businesses do indeed meet the criteria of a business.

## 3.7 Tax avoidance and evasion by some in the self-employed, contractor community

CA ANZ is increasingly concerned at what we see occurring in some parts of the self-employed, contractor community.

In particular, we think that the tax reform process should address the following issues:

- The integrity of the ABN registration process (workers who are in effect employees apply for and obtain an ABN, sometimes for personal reasons but in other cases, because they seek work with a payer whose hiring approach is 'No ABN, No Work')
- The quotation of false ABNs and\or the provision of fake tax invoices to payers (particularly in the building and construction industry, and short term labour hire sectors)

- The non-application of the PAYG instalment regime until such time as the self-employed person first lodges an income tax return after they become self-employed (and then often struggles to pay the initial assessed income tax liability and future instalments)
- Cash economy transactions in the business to consumer and business to business context
- False deductions claimed, sometimes using fake invoices or cash receipts issued to others, and
- The treatment of private expenses as business-related expenses and, for mixed purpose expenditure, apportionment uncertainty (a formulaic approach or ATO approved 'rule of thumb' safe harbour guidelines would be useful).

The above list also has major implications for GST collections.

## 3.8 Learning from the reportable payments regime in the building and construction industry: is it time to consider a domestic contractor withholding tax?

By now, the ATO will have data for the initial year of operation of the reportable payments regime introduced for the building and construction industry.

Given the concerns we expressed in the previous section about self-employed individuals, we believe there will be learnings from this data which will inform tax reform thinking about both payers and payees operating in this sector. This data should be made public as part of the tax reform process.

If the data has exposed a sizeable income 'tax gap' between the payments reported and the payments declared as income (and an accompanying GST 'tax gap' also), then we believe that the Government should move beyond a mere reporting framework and consider a domestic withholding tax on business to business contractor payments. There are also other sectors of the economy where a domestic contractor withholding tax could apply (eg industries where short term labour hire arrangements are common).

Those payees with a good track record of reporting their income to the ATO could apply for an exemption certificate and operate outside the withholding regime. An exemption certificate would also be conditional on the payee embracing modern methods of tax reporting (ie the use of SBR compliant software).

We appreciate that a B2B domestic contractor withholding tax will be seen by some as more red tape, but withholding is a highly efficient mechanism not only to collect tax, but to bring payees into the tax compliance system (with the attendant ATO data collection and analysis framework which helps ensure compliance going forward).

CA ANZ has concerns about the integrity of the ABN registration system, the misuse of ABNs and the delay in bringing self-employed persons into the income tax net.

If these concerns are shared by the ATO, we believe that it is time to consider a domestic contractor withholding tax and changes to the current entry rules for the PAYG instalment regime.

## 3.9 The illegal cash economy

Despite the ATO's efforts, CAs continue to report that some of their SME clients are under pressure from low cost competitors who operate in the illegal cash economy[24]. Sectors commonly identified include:

- The provision of building and construction related services
- Automotive services (including tow truck services)
- The sale of self-produced goods (eg grower markets)
- Domestic services
- Rural labour and equipment services
- Restaurant and catering

GST has not proven to be as effective as had been anticipated in countering the cash economy in terms of creating an investigation 'trail' between supplies purchased and reported income. For example, a painter engaged to paint a house can ask the householder to acquire the paint directly from a hardware store and then be paid in cash for the painting services provided (ie ATO data collection cannot correlate the painter's paint purchases to the services performed).

Non-cash arrangements are also used to avoid ATO scrutiny. For example, a farm labourer might be paid partly in diesel fuel pumped from the on-farm fuel storage tank.

And of course we have the emerging digital economy (eg Uber, Airbnb etc) which the government has recently sought to address, at least in the context of imported services. A whole new group of individuals now see opportunities for new sources of income from online customers.

Aside from the B2C context, there is also enough anecdotal evidence to suggest that there are some residential landlords who extract cash rental payments from tenants, sometimes in return for a small discount on the rent. We suspect that there could be a sizeable amount of undisclosed rent derived by those who remain under the ATO's radar because they do not claim deductions against their rental income.

We do not think the illegal cash economy can be eradicated, but we do say that new policy thinking is required.

Rather than expect the ATO to do all the compliance work on the illegal cash economy, we think it is time for a whole of government and community response which involves non-tax agencies and entitlements we often take for granted.

For example:

- A landlord could be denied standing at law (eg in tenancy disputes, damages claimed against the tenant, rental property insurance disputes) unless in possession of a tax compliance certificate from the ATO[25]

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[24] There is nothing wrong in operating a cash business. We use the term illegal cash economy to refer to arrangements where the income is not disclosed.

[25] In Ireland for example, interest on money borrowed to purchase or improve rented residential premises is not deductible unless the taxpayer has complied with the registration requirements of the Private Residential Tenancies Board.

- Consumer protection mechanisms could be denied unless the complainant is in possession of a valid tax invoice issued by the business against whom the complaint is made
- Business licencing and renewal could be made dependent on a tax compliance certificate from the ATO, and
- Contractor compensation and public liability claims would require presentation of a valid tax invoice issued by the injured service provider

We would also like to explore with policy-makers the concept of a taxpayer ‘good behaviour’ bond which could be used (perhaps as an alternative to penalties in suitable ‘first offence’ cases) to help bring taxpayers back into a compliance mindset. After that, tougher penalties should apply.

Any crackdown on the cash economy could be preceded by a domestic amnesty arrangement for taxpayers to regularise their tax affairs, looking back over the last four years (somewhat similar to the ATO’s Project DO IT approach).

These ideas may seem extreme.

But what we are saying is that we all live in a community and tax compliance is a basic community rule. Tax compliance needs to become more embedded in how the community thinks and operates. Those who continue to choose to operate outside the tax system in the illegal cash economy, or who facilitate such non-compliance, should not enjoy all the entitlements and protections afforded to law-abiding members of the community.

It is time for a renewed attack on those who operate in the illegal cash economy, exploring new non-tax approaches as well as reviewing the effectiveness of existing ATO strategies.

**Our submission comments below on the following discussion question in the TDP:**

14. Under what circumstances is it appropriate for assistance to be delivered through tax offsets?

## 3.10 Personal tax offsets

Our view is that personal tax offsets which reflect a policy of supporting needy members of our society should be removed from the income tax system and replaced by direct transfer payments.

Our reasons for this stance are as follows:

- Such offsets add complexity to the income tax law, whereas they could be part of a streamlined whole of government framework for a support payment (we note recent government moves to reduce the number of such payments)
- The tax system is not an ideal framework to determine entitlements. Tax planning can in some instances be used to game the system.
- The income tax calculation is of necessity performed after the end of the financial year – this time ‘lag’ also makes the tax system an imperfect determinant of eligibility (we would rather a determination of eligibility made contemporaneously with the application for a transfer payment, using shared online data from the ATO and other relevant agencies), and

- There have been instances where the ATO has encountered difficulty amending prior year tax assessments for over-claimed personal tax offsets (creating so-called 'churn' effects and compliance costs).

As illustrated by the health insurance rebate, the private sector can also be prevailed upon to reflect entitlements through reduced costs (insurance premiums) rather than a tax offset.

Together with policy input from government agencies such as the Department of Human Services, the Digital Transformation Office and civil society groups such as ACOSS, the Green Paper should explore the possibility of reducing the complexity of the income tax system by removing all remaining personal tax offsets, and substituting direct transfer payments or other, simpler delivery mechanisms.

**Our submission comments below on the following discussion question in the TDP:**

15. To what extent do our arrangements for work-related expense deductions strike the right balance between simplicity and fairness? What could be done to improve this?

## 3.11 Work-related expense deductions

The level of work-related deductions claimed by employees and self-employed individuals has grown over the years (see below), and appears to have reached a level where – to protect the revenue base – new approaches are needed. The thinking in this area should also be based around simplifying the tax system.

**Total work related deductions**

| Tax Year | A$m |
|---|---|
| 1999-2000 | 7,763 |
| 2000-2001 | 8,753 |
| 2001-2002 | 9,630 |
| 2002-2003 | 10,207 |
| 2003-2004 | 11,101 |
| 2004-2005 | 11,930 |
| 2005-2006 | 13,067 |
| 2006-2007 | 14,166 |
| 2007-2008 | 16,098 |
| 2008-2009 | 16,362 |
| 2009-2010 | 17,939 |
| 2010-2011 | 18,270 |
| 2011-2012 | 19,358 |
| 2012-2013 | 19,761 |

*Source: Australian Taxation Office Taxation Statistics – various issues.*

As noted previously, we favour a mechanism which gives employees with straightforward income tax affairs a standard tax deduction (or allowance) so that they can opt-into a compliance system in which the lodgement of income tax returns is unnecessary. Standard deduction entitlements could also be developed for various self-employed occupations, based on ATO data on the average deduction claimed for those in that industry.

Individuals who wish to pursue deductions above the standard amount (eg for post-graduate study relevant to their employment or occupation, overseas travel) would need to lodge a return and substantiate in detail.

We acknowledge that this proposal will attract criticism (there was a failed attempt by the former Labor Government to implement a similar policy from 1 July 2013). To pre-empt and seek to address such criticism:

- A trade-off in terms of a reduced personal tax rate (as part of overall reform) would seem necessary to garner community support.
- For employees, the standard deduction would be reflected in take-home pay (ie using the proposed single touch payroll technology, less PAYG withholding would apply at source)
- Standard deductions are also part and parcel of lowering tax compliance costs for individuals (see above), and this would also need to be explained as a trade-off benefit.

As part of the trade-offs designed to deliver personal income tax cuts and other benefits flowing from tax reform, the Green Paper should propose opt-in standard deduction entitlements for employees and self-employed individuals.

**Our submission comments below on the following discussion question in the TDP:**

16. To what extent does our fringe benefits tax system strike the right balance between simplicity and fairness? What could be done to improve this?
17. To what extent are the concessions and exemptions in the fringe benefits tax system appropriate?

Refer comments in this submission at section 3.2 above.

# 4: Savings

## 4.1 Rationale for the taxation of savings

In a 2009 speech on this topic[26], Dr Ken Henry stated that:

> "We have a system for taxing personal capital income that has evolved into something that is, to put it mildly, far from the originally intended ideal. Further, the case for staying true to that original ideal now appears weak; while the case for moving to the other conceptual ideal is not strong either."

In the same speech he also referred to recent work in this area, and said "there are arguments for taxing savings at a higher rate than labour, arguments for taxing savings at a lower rate than labour, arguments for subsidising saving and there are even arguments for taxing savings at age-dependent rates."

The rationale for taxing savings has not progressed significantly from that time and, as noted in the TDP, there are many contentious issues.

Yet, whilst the rationale for taxing savings has not been clarified, there appears to have been a change in approach in relation to the taxation of domestic capital.

Dr Henry noted in his 2009 speech the importance of domestic saving rates to Australia's economy and especially our future living standards:

> "The global financial crisis serves as a reminder that countries, like Australia, with high rates of domestic investment cannot take for granted that it will always be financed by a perfectly elastic supply of foreign saving to supplement domestic savings. The level of domestic savings matters. The composition of domestic savings may also matter. This is particularly the case if there are significant externalities involved in domestic saving being in a form that can adjust quickly to shifts in foreign capital flows….Another consideration worth thinking about is that while domestic investment can be financed either by domestic saving or the saving of foreigners, the future living standards of today's working Australians will have more to do with the returns generated by the former - that is, the returns on their own savings. As the Australian population ages, the quality of our domestic saving decisions is going to become increasingly important."

In contrast, the TDP states that "if taxes on income from domestic savings are raised, but not taxes on income from foreign investment in Australia, it is likely that total investment in Australia would be largely unaffected, as foreign savings would be expected to replace the fall in domestic savings."

This could be interpreted as indicating that the review is considering taxing domestic capital more highly than international capital given that there is an abundance of international capital or alternatively that a reduction in domestic savings (or a reduction in the tax concessions provided to domestic savings) may not have a substantial impact on the level of investment in Australia. What is left unsaid is 'Why?', and evidence as to what now makes Australia less vulnerable to sudden international events than when Dr Henry made his remarks. Perhaps one factor is that Australia has made superannuation compulsory, and thus the domestic taxation framework will not unduly impact supply.

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[26] Towards a better taxation of savings, Dr Ken Henry speech to the Australian Conference of Economists Business Symposium 2009. Source: http://archive.treasury.gov.au/contentitem.asp?ContentID=1635

**Taxation of savings**

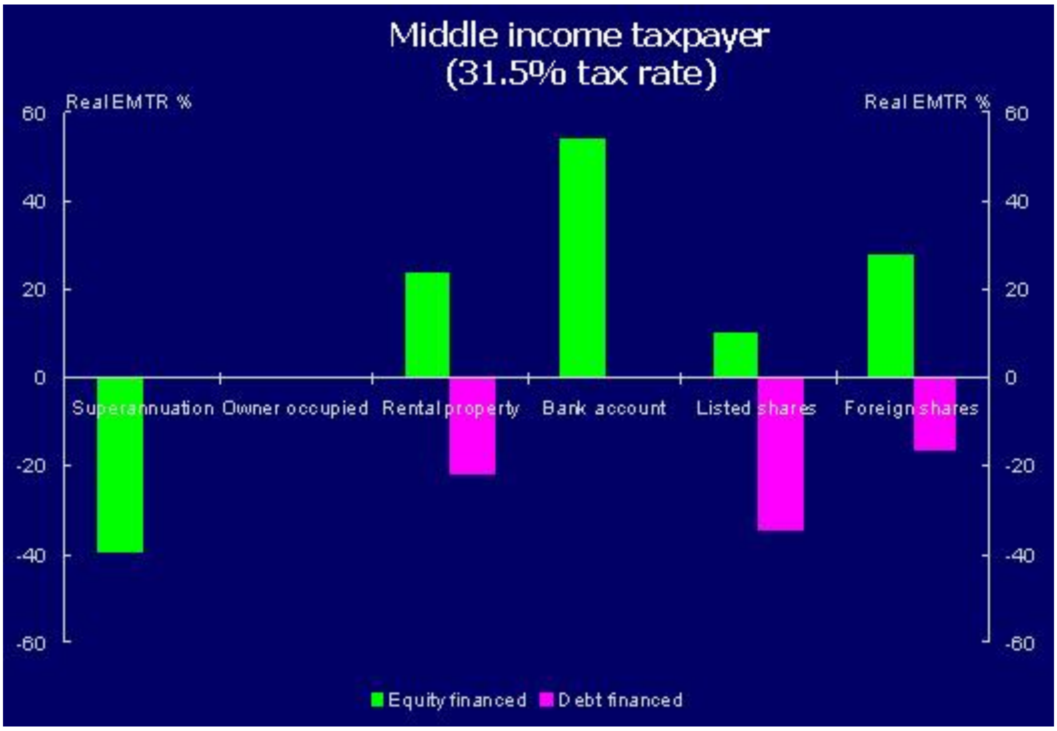
Implementing tax reform requires persuading people about the legitimacy of various views. The lack of consistency in the theoretical rationale for the taxation of savings makes it difficult to justify from an equity perspective a differential treatment of income from capital and labour and domestic and international capital. Any discussion concerning the taxation of savings in the Green Paper needs to articulate the broad principles underlying the proposals.

## 4.2 Effective marginal tax rates of types of savings

In the absence of strong economic rationale for a particular form of taxation for savings, it would appear to be appropriate to look at the actual tax treatment of savings and the investment decisions of Australian residents to determine whether or not the Australian tax system is influencing investment choices. If the tax system is influencing investment choices, the second step is to then consider whether this is an appropriate policy outcome.

As demonstrated in following chart extracted from Dr Henry's speech, the variety of taxation methods does result in significant different effective marginal tax rates for investments:

**Different treatment of savings types**



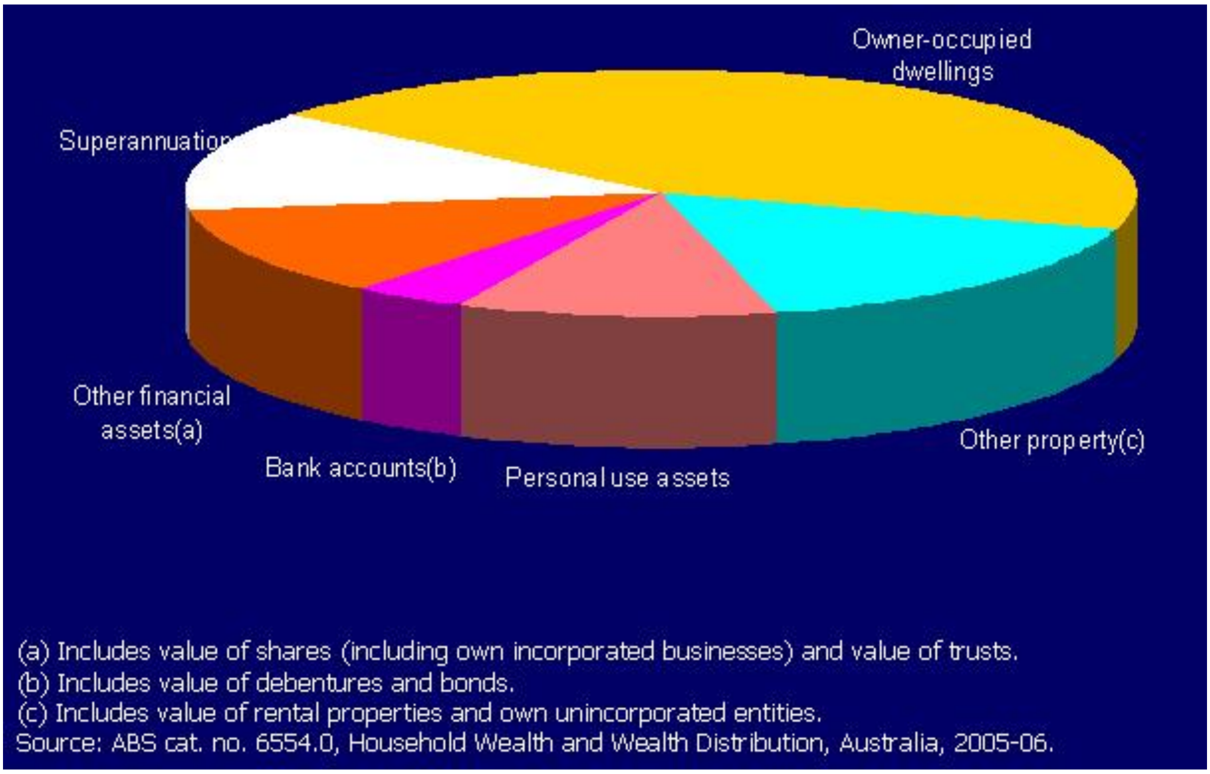

## 4.3 Our taxation of savings may also be reducing our productivity

The Henry Tax Review also observed that: "Productivity is reduced if tax-induced distortions lead to a misallocation of resources, with savings directed towards less productive investment opportunities."[27]

[27] Source: http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_a1-3.htm

The following chart (again taken from Dr Henry's 2009 speech) illustrates the composition of household assets in Australia.

**Composition of household assets**




This chart illustrates that most household savings are primarily in owner occupied property and then in investment property and superannuation. Most of the investments shown are either exempt from tax or very lightly taxed.

This suggests that the taxation system may be having a significant impact on the allocation of assets and that the tax system is distorting investment decisions and potentially contributing to lower productivity.  The next question then comes into play, is this appropriate from a broad policy perspective?
Whether this is appropriate from a policy perspective is further discussed under the headings relating to the CGT discount at section 4.6, negatively geared properties at section 4.7 and superannuation at section 4.8.

## 4.4 Our taxation of savings – Complexity and vertical inequity aspects

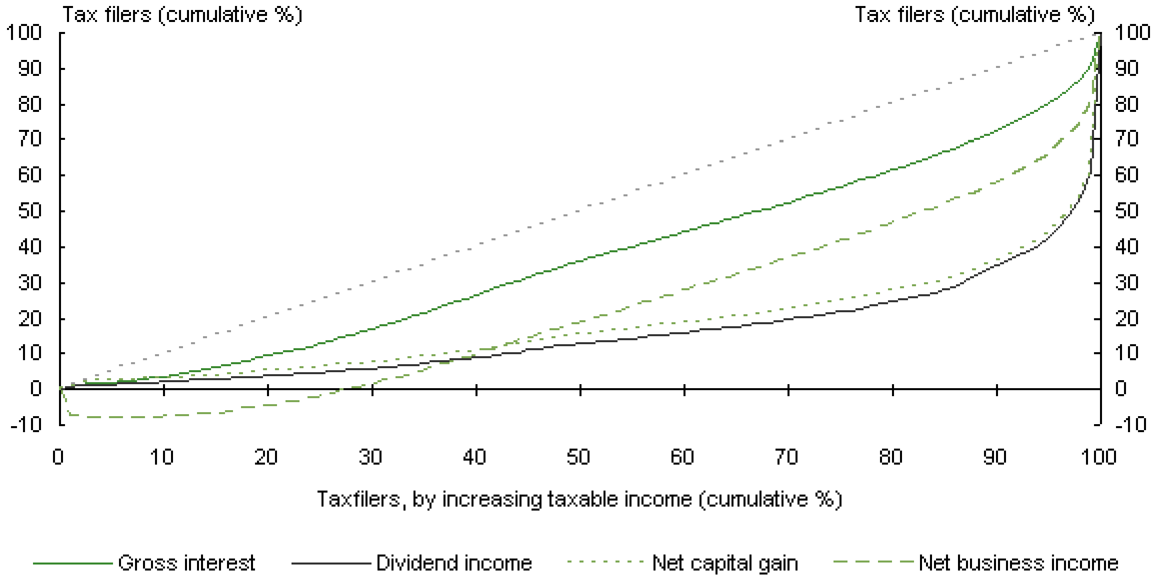
Whilst it not often discussed, the way in which savings are taxed concessionally is a source of complexity in the tax law.

Bearing in mind that high wealth households have more disposable income to save, the Henry Tax Review also noted considerable differences in the distribution of the income from these different saving forms between households[28]:

- Taxable income from savings is typically skewed towards high income taxpayers. Interest income, however, tends to be more evenly distributed over the taxable income scale. Dividends and capital gains are the least evenly distributed.
- In 2007–08, the bottom 20% of taxpayers earned around 9% of gross interest income but only 4% of dividend income and around 5% of net capital gains.
- In contrast, the top 10% of taxpayers received around 27% of gross interest income but over 60% of net capital gains and dividends.

This was illustrated in Chart A1-18 of the Henry Tax Review.

## Chart A1–18: Distribution of savings income items, 2007–08




Source: Australian Government administrative data, includes taxfilers without a tax liability

This indicates that high net wealth individuals may have greater capacity to not only save but to also convert labour income into concessionally taxed forms of saving income, such as superannuation and property, or, divert savings to the more tax preferred type of savings.

CA ANZ agrees with Henry Tax Review general principle that savings should be taxed as consistently as possible to minimise tax arbitrage opportunities and to avoid biasing household and investor decisions about what assets best suit their needs and preferences.  Having said this, it is acknowledged that certain sypes of savings (eg owner occupied housing and superannuation) do warrant separate consideration.

In the longer term, we support further consideration of a common savings income discount to replace the current diverse range of tax treatments for capital gains, housing rents, interest bearing deposits, shares and similar investments (but excluding superannuation and owner occupied housing).  In the more immediate future, we suggest that consideration be given to lowering

[28] Source: http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_a1-3.htm

the CGT discount, possibly with the view of using the revenue gained from this to lower the personal income tax rates. We also suggest reviewing the purpose and effectiveness of the superannuation provisions – this is discussed in further detail in section 4.8 below.

**Our submission comments below on the following discussion question in the TDP:**

18. What tax arrangements should apply to bank accounts and debt instruments held by individuals?

## 4.5 Interest income

Interest income is currently taxed more highly than any other savings income as it is taxed fully at the investor's marginal tax rate.

In 2010-11 Federal Budget, the then Labor government announced that, from 1 July 2011, it would provide individuals with a 50% tax discount on up to $1,000 of interest earned by individuals, including interest earned on deposits held in authorised deposit-taking institutions, bonds, debentures and annuity products. Treasury consultations subsequently occurred[29].

The policy intent was to reduce the discrepancy in the treatment of interest income relative to non-interest earning investments.

However, this measure was subsequently withdrawn in Labor's 2012-13 Federal Budget. The reasons given were that there had been a significant increase in savings since the prior budget announcements and that the "Government's public consultation process had made it clear that the tax discount for interest income would be difficult to implement and may not have had a significant impact on savings behaviour[30].

One academic has since estimated that reducing the taxation of interest income could cost the Government up to $5 billion a year in lost revenue yet not provide any benefits to non-taxpayers such as self-funded retirees earning less than the income tax threshold.[31] Given the need to ensure that Australia has adequate revenue to fund its ever increasing expenditure associated with an aging population, reducing the taxation of interest may not be a sustainable option in the short-medium term.

We also note comments in the TDP that high income earners are most likely to divert a portion of their savings to access any tax preferences rather than increasing the savings pool, and moreover, the introduction of a discount for interest income whilst allowing full deductions would open up significant tax arbitrage opportunities.

Accordingly, we do not see the taxation of interest income for individuals as an immediate priority. But as noted earlier, and for the reasons given in the Henry Tax review, we still think that in the longer term there is merit in reducing the discrepancy in the taxation of various types of savings, including interest.

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[29] Source: http://archive.treasury.gov.au/documents/2082/RTF/20110707%20Discussion%20Paper%20(FINAL).rtf

[30] Source: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/034.htm&pageID=003&min=wms&Year=&DocType=0

[31] Banks want you to pay less tax on interest, but why? John McLaren, *The Conversation*, 3 April 2014. Source: http://theconversation.com/banks-want-you-to-pay-less-tax-on-interest-but-why-25022

**Our submission comments below on the following discussion questions in the TDP:**

19. To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?
20. To what extent does the dividend imputation system impact savings decisions?

## 4.6 CGT discount

The taxation of capital gains is, to say the least, tricky.

An economic ideal would be to tax the capital gains and recognise capital losses as they accrue. However, for practical cash flow reasons, most jurisdictions tax capital gains and losses upon realisation.

Because of recent changes to the CGT treatment of non-residents individuals, the focus of any tax reform in this area is now on resident individual taxpayers and superannuation funds.

The then Coalition government introduced the flat 50% discount on capital gains in 1999, following the Ralph Review of Business Taxation. Although this measure sought to address issues caused by Australia's taxation of capital gains at the same rates as ordinary income (which was out of kilter with other jurisdictions), it has always been unclear how the discount was determined.

The Henry Tax Review recommended a 40% savings income discount for individuals on non-business related capital gains, a recommendation which may still have merit.

For the reasons given in the Henry Tax Review, and as part of a policy response to the negative gearing of residential property (see below), we are open to a reduced CGT discount being explored in detail.

Accompanying such as review, consideration should also be given to providing a 'bright line' as to whether an item is revenue or capital in nature. Such an approach has the potential to reduce compliance costs and to increase certainty for both taxpayers and the revenue authorities

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**Our submission comments below on the following discussion question in the TDP:**

21. Do the CGT and negative gearing influence savings and investment decisions, and if so, how?

## 4.7 Negatively geared property investment

There has been much commentary about the impact of negative gearing on the cost and supply of residential real estate, with first home buyers and others seeking to purchase and occupy depicted as disadvantaged.

On the other hand, it is also easy to find commentators advocating negatively geared property investments as beneficial, both in terms of wealth creation and in encouraging construction and investment in properties available for rent.

There have been recent statements by senior Government Ministers indicating that this is an area of tax reform unlikely to be embraced by the Coalition parties.

During all of this discussion, what remains unclear is the extent to which tax influences the behaviours outlined by the proponents and critics of negative gearing.

Land is of relatively fixed supply. It can only increase if State and Territory governments (supported by local government policies) open up more land for development, rezone land for more intensive uses or undertake land reclamation activities.

Land cannot become more available due to its tax treatment.

Demand for land can, however, increase (and thus make land more expensive) due to its income tax treatment. But negative gearing is not the only tax factor at work here. For example, the CGT main residence exemption is one of the few ways that individual taxpayers can make a tax free gain.

There is also evidence of increased overseas demand for Australian residential property in the larger State capital cities, although FIRB data would suggest that this demand is not as great as sometimes portrayed in the media. Some CAs report that this demand reflects a 'flight to quality' or sovereign risk strategy by some overseas investors. In other cases, overseas investors – have been introduced to Australian property investment opportunities by their adult children studying at Australian universities (in some cases these children aspire to become Australian residents and their parents are keen to help financially).

From a policy perspective, negative gearing represents a relatively straightforward application of the general deduction principle in section 8-1 ITAA 1997.

To totally or partially deny interest deductibility for one type of income producing investment and not others is itself distortionary, with some taxpayers likely to adapt by simply shifting their gearing strategy to some other class of income producing asset.

We can recall the practical policy design problems encountered when negative gearing restrictions last applied during the 1985 to 1987 income years. These included:

- Implementation and grand-fathering issues
- Differentiation between business and non-business borrowing
- Tracing of borrowed funds
- Re-financing
- Definition of residential property
- Treatment of interposed entities
- Application of the rules to changing occupancy and family arrangements from year to year, and
- Compliance costs

As noted above, the Henry Tax Review recommendation of a 40% savings income discount would have applied to net residential rental income (including related interest expenses), although the Committee was conscious of disruptive implementation effects and said this particular reform should only be adopted if accompanied by reforms to the supply of housing and reforms to rental assistance.

Since the time the Henry Tax Review however, the supply situation has worsened in some centres (particularly Sydney) and rental assistance is impacted by the Budget situation The recent Murray Inquiry[32] noted the asymmetric tax treatment of interest costs and other expenses (deductible) and capital gains (taxed concessionally) and the encouragement this gives to leveraged and speculative investment, particularly in housing.

It also said higher housing debt has been accompanied by a greater exposure to mortgages by lenders, with the housing market now a significant source of risk for the financial system and the economy. On this particular point, we have been pleased to see that some lenders have since responded to these warnings by adjusting their lending policies for investment properties.

There are many suggestions on what should be done.

One is to allow gearing deductions but only for investment in new housing stock. But the -Grattan Institute chief executive John Daley recently noted that, if negative gearing was so restricted, a key issue would be the transition. "It would create incentives to hold anything you already own, potentially locking up housing in an unproductive way, given that the average investment property is at present only held for three to four years." [33]

Some say only allow a partial deduction should be allowed for interest[34].

Another suggestion has been to reduce the percentage of rental property tax loss that can be claimed or to quarantine the loss completely to the particular class of income which the investment generates. The latter approach reflects the policy thinking of the 1985 to 1987 experience which, as we have noted, had its problems. In terms of equality of treatment, wealthier property investors with multiple rental properties prospered during this period: they had plenty of rental income against which to offset their rental deductions. It was the newcomer to residential investment market who was most impacted.

These approaches could also create an uneven playing field between domestic and overseas investors (depending on how rental income and associated expenses are treated in the foreign country).

For the time being, and primarily on the grounds of simplicity and consistent treatment of interest expense, our preference is not to interfere with the deductibility of interest on money borrowed for residential investment, but rather focus on re-examining the quantum of the CGT discount. The introduction of a lower CGT discount for resident individuals could have some impact on the current levels of negative gearing of residential property and further modelling on this would be useful.

In the longer term, we encourage the examination of a more consistent basis for taxing savings income (see above).

[32] Source: http://fsi.gov.au/ Refer Appendix 2, Tax Summary.

[33] http://www.smh.com.au/business/federal-budget/boom-puts-spotlight-on-negative-gearing-20140411-36him.html

[34] In Ireland for example, the interest deduction on loans used to purchase or improve rented residential property is restricted to 75% of the interest accruing on or after 7 April 2009 (the date the loan is taken out is irrelevant). The 75% restriction does not apply to loans relating to non-residential property.

**Our submission comments below on the following discussion question in the TDP:**

22. How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

## 4.8 Superannuation

### 4.8.1 Setting the objectives

Assessing the fairness and complexity of the tax arrangements in Australia's superannuation system will always be a difficult task until such time as we are able to clearly articulate not only what we want from our super system but more broadly from our retirement incomes system. Even then, it will not be enough to strive for fairness and simplicity but just as importantly, effectiveness and efficiency.

An otherwise fair system will be of limited use if it comes at the expense of an effective system in which the goals of the Australian Government and the Australian people for retirement living cannot be achieved. If that 'fair' system resulted in greater reliance on the age pension and increased levels of disengagement with the super system, the whole system may ultimately fail. What is required is the setting of objectives for our retirement income system - a set of ideals with which to assess changes to the system and balancing out these ideals to ensure the objectives are achieved.

CA ANZ strongly support the recommendation of the Financial Systems Inquiry to set objectives for Australia's superannuation system but we would also encourage broadening this work to create a set of objectives for our retirement incomes system. Once this is done, a comprehensive review of the tax settings to achieve the objectives should be undertaken.

### 4.8.2 The pace of change should be reduced

We have long argued there has been too much tinkering within superannuation and against its frequent use as a budgetary tool in the annual Federal Budget. The specific changes made are often not related to efficiencies or equity in the super system but the need of the government of the day to 'balance the books'. This has resulted in a reduction in the confidence Australians have held for super. Confidence and willing participation in the system are integral to its future success. We urge the Government to consider this as part of any further changes. While the public may tolerate further changes if they are delivered as part of an overall reform package, they will not do so if they see changes as a raid on their retirement savings for the Government to raise revenue.

In relation to tax reform for superannuation, we make the following comments:

- Tax concessions are often designed to drive certain behaviours. We need to ensure that changes to the placement of tax concessions do not inhibit the very actions we would like to encourage, ie saving for and ensuring a comfortable retirement. For example, tax free earnings in retirement phase was introduced to encourage people to take income streams from their super (considered more desirable) rather than lump sums. Aligning the earnings tax rate for funds paying income streams may have some impacts on this incentive, albeit as noted later on, this tax concession may still need to be reviewed.

- It will be important to use real data to assess tax concession placement, not anecdotal evidence. Large super balances, particularly in SMSFs are not actually that common but tend to dominate debate on the taxation in super.
- Super is considered a tax advantaged saving tool – an incentive to save. If the result is greater retirement savings, this should be seen as a positive. We caution against being critical of the very behaviour that tax concessions are designed to encourage.
- We should be striving to ensure that those who are most likely to be able to provide for themselves in retirement are given the appropriate support to be able to do so. Conversely, some people will never be able to save sufficient amounts for their retirement and providing incentives to do so will be fruitless. These citizens will need to be provided with adequate support via the age pension.

We strongly urge against piecemeal changes to superannuation tax settings, even to address a seeming anomaly in the system. All current tax settings should be assessed against objectives and adjustments made accordingly.

### 4.8.3 Particular superannuation issues

Subject to our recommendations above concerning a holistic review of the superannuation tax settings, we make the following comments regarding certain aspects of the current taxation settings for superannuation.

#### Low Income Superannuation Contributions (LISC)

While the compulsory nature of employer superannuation contributions exists, CA ANZ strongly encourages the re-introduction of the LISC. No person should be financially worse off by a system that requires their salary and wages to be directed into superannuation. Without LISC, low income earners who would otherwise pay little or no tax for salary and wages received in hand are forced to forgo that money, only for it to be directed into superannuation where it will incur a 15% contributions tax. In terms of fairness and equity, this anomaly is a significant issue that requires addressing. Notwithstanding the merits of a compulsory super system to ensure greater levels of saving for retirement, no person should be penalised which is the case without the LISC.

Under the current tax arrangements for superannuation contributions, CA ANZ encourages the reintroduction of the LISC.

#### Intergenerational transfer of wealth

We have to accept that by the very nature of our superannuation system, there will always be an element of intergenerational wealth transfer. We encourage Australians to save for their retirement, bearing in mind ever increasing average life expectancies. The reality of such averages is that 50% of people live longer than the average and 50% die before reaching it. Therefore, the probability is that a large number of people will have superannuation ‘left over’ and will seek to pass it onto their dependants.

As no individual can know exactly when they will die, we believe it would be a dangerous precedent to require people to withdraw their superannuation based on average life expectancies or seek to have a zero balance on death. Averages are useful as a guide but are clearly not definitive on an individual basis.

CA ANZ cautions against the use of average life expectations when formulating superannuation policy.

## Superannuation Guarantee

Superannuation Guarantee, as the compulsory contribution pillar of our superannuation system is the foundation on which we seek to build retirement savings to ensure a comfortable retirement.

CA ANZ strongly encourages the Government to expedite increases to Superannuation Guarantee to 12%. Further delays in increases only prolong the time before the first Australians are able to get the benefit of 12% for their full working lives. As it is, it will be fifty years or more before anyone is able to retire having had the benefit of the full 12% Superannuation Guarantee for their entire working life.

CA ANZ recommends that the Superannuation Guarantee increase to 12% as soon as possible.

## Concessional contribution caps

We strongly encourage consideration to allowing concessional contribution caps on a carry forward basis, rather than an annual limit on a 'use it or lose it' basis. The reality for the vast majority of people is that they will never be able to contribute the maximum amount of the cap each year. Whether this is because of lower wages in the early stages of a career, paying mortgages or simply raising families and educating children, most Australians will be limited for significant periods of time in their capacity to make additional contributions beyond super guarantee amounts.

CA ANZ support the ability for unused contributions up to the annual concessional contribution cap to be carried forward into future years. This will facilitate larger contributions at periods of time when people are able to catch up. We also believe this would be more equitable than a lifetime limit on concessional contributions that may encourage larger, lumpy contributions early on that would mainly benefit higher income or high wealth individuals.

We acknowledge some carry forward restrictions may also need to be considered depending on Revenue costings.

CA ANZ recommends that the Green Paper consider allowing concessional contribution caps on a carry forward basis.

## Non-concessional contribution caps

The ability for Australians to make non-concessional contributions is an important aspect of the superannuation system. These voluntary contributions contribute significantly to the overall balances of many Australians to ensure adequate retirement savings. However, the current annual limit (with the ability to bring forward two years contributions) enable significant contributions to be made over a person's lifetime, which would clearly benefit high wealth individuals who are able to contribute well in excess of what may be required for a 'comfortable' retirement. Many of these people would otherwise have the means to support themselves in their retirement without the need to contribute high levels of non-concessional contributions.

The current system however does accommodate the ability for people to make contributions at times when they are in receipt of larger, one-off amounts such as an inheritance, sale of an investment property or sale of a business. We believe any changes would need to continue to allow larger contributions at these times.

We therefore suggest consideration of a lifetime cap on the amount of non-concessional contributions.

We note also that there may be people who are unable to contribute sufficient amounts in concessional contributions and who may need the ability to contribute higher amounts of non-concessional contributions. This may include those who receive limited employer support and are unable to claim a tax deduction for personal contributions because of that minimal employer support (e.g. those that do not satisfy the 10% rule to enable personal concessional contributions.) People in these circumstances will need to be considered in terms of life-time caps or alternatively steps may need to be taken to remove obstacles to them making concessional contributions.

The impact on small business owners and the interaction of the small business CGT exemptions would also need to be considered. This is also discussed in section 6.8 of our submission.

CA ANZ recommends that the Green Paper consider a life time cap on the amount of non-concessional contributions.

## 10% rule for personal concessional contributions

The current "10% rule" means that only taxpayers who earn less than 10% of their assessable income from an employer source can claim a tax deduction for personal superannuation contributions. Access to this deduction is actually only available to relatively few people, generally those who are fully self-employed as sole traders.

Many employers currently allow their employees to salary sacrifice additional superannuation contributions, effectively overcoming the inability of their employees to claim their own deduction. By forgoing salary and wages to contribute (or have contributed for them) tax effective superannuation contributions up to the concessional contribution cap, they have overcome any need for directly claiming a deduction for otherwise personal contributions.

Effectively this means employees whose employers do not allow them to salary sacrifice are disadvantaged. Australians trying to save for their retirement should not be deprived of superannuation concessions by working for an employer who does not allow them to salary sacrifice into superannuation. In our view, it would be more simple, equitable and efficient to permit employees to make personal concessional contributions in order to "top up" their employer contributions.

We acknowledge some restrictions may need to be considered subject to revenue costings.

Significantly, amendments to current law would ease the administrative burden on employers, particularly small businesses, as they would no longer be compelled to offer their employees salary sacrifice arrangements for superannuation. The onus for facilitating additional superannuation contributions would be taken away from employers and put back in the hands of the individual.

CA ANZ strongly encourages consideration to tax deductions for personal superannuation contributions being made available to all income earners including employees who currently receive employer superannuation support.

## Transition to retirement income streams

There is merit in allowing Australians to transition into their retirement. For many people, as they head towards their retirement, full time work is no longer desirable. Part time work is still attractive however the reduced income may need to be supplemented by an income stream from their super fund. The policy objective behind transition to retirement income streams was to enable people to have an alternative between the two extremes of full time work or ceasing work and accessing superannuation. The ability to start withdrawing from super under these arrangements facilitates ongoing workforce participation, albeit part-time and has the added benefit of many of them not accessing the age pension, at least in the interim.

However, the trigger for commencing this type of income stream is attaining preservation age and does not include any nexus with any actual change in work circumstances. As a result they have become a tool for tax planning purposes. People can commence a pension while still working full time, pushing their super funds into a tax free environment for earnings and swapping higher taxed salary and wages for lower taxed super income through salary sacrifice arrangements.

CA ANZ believes that transition to retirement income streams remain a positive for many Australians but only to the extent that the policy objective behind them is being met. To do so, we believe that a change in work circumstance criteria could be introduced or consideration should be given to removing access to tax free earnings for these types of income streams until such time as another condition of release is satisfied, at which point they would become a normal income stream rather a transition to retirement income stream. We note that while there may be other tax benefits to commencing these types of pensions, concessional contribution caps will limit these.

CA ANZ recommends that the Green Paper consider inserting a work test in relation to transition to retirement income streams.

## Tax free earnings in superannuation funds paying income streams

The tax free nature of superannuation funds paying income streams is often seen as being the overly generous. While CA ANZ believes that this may need to be reviewed in terms of level of tax or access to this concession, we urge the Government to consider the intent behind the policy. Removing income tax (including capital gains) on earnings from assets that were being used to pay an income stream acts as a strong incentive for people to withdraw from their superannuation as a gradual income stream rather than as a lump sum. This was considered desirable to ensure people's superannuation lasted longer and reduced either the likelihood of them accessing age pension or the amount of age pension they were eligible for.

CA ANZ believes incentives need to remain for Australians to take an income stream rather than a lump sum and any changes to the tax free status of pension paying funds needs to ensure that incentives remain.

Note however, that we do not support mandatory income streams as a way of ensuring longevity of super savings. Many Australians do not have sufficient retirement savings for this to be viable and we also note that this may impact detrimentally on a person's individual financial arrangements. For example, they may be financially better off by withdrawing (partially) a lump sum to pay off a mortgage.

CA ANZ cautions that the behavioural aspects of the original policy intent behind tax free earnings in superannuation funds paying income streams needs to carefully considered as well as the revenue impact when this issue is considered in the Green Paper.

## Maximum balance to access super concessions

Concessions for super contributions exist to encourage greater levels of saving in superannuation to ensure Australians are able to attain sufficient savings for a comfortable retirement. They also compensate people for committing their savings to the superannuation environment, inaccessible until they satisfy a condition of release (usually retirement).

Part of the trade-off for the Government in providing incentives for people to save for their retirement is also the expectation that their reliance on the age pension will be reduced or eliminated. The cost to Government therefore is in foregone revenue in providing tax concessions as opposed to payment of welfare benefits in the form of age pension later when people retire.

There does come a point however when the provision of incentives results in people saving sufficiently for them to retire comfortably with no expected reliance on age pension. Therefore, the tax concessions have served their intended purpose and act as nothing more than a tax planning tool.

CA ANZ support the concept of capping access to superannuation tax concessions once a high enough balance has been achieved. However, we caution that there are many circumstances in which a 'high enough' balance will vary significantly – number of dependants, nature of dependants (disabled children or invalid parents), owning home or renting, life expectancy etc. The amount would have to be set at a high enough level that people would not ultimately be disadvantaged or end up age pension recipients anyway.

**Our submission comments below on the following discussion question in the TDP:**

23. What other ways to improve the taxation of domestic savings should be considered? How could they be applied in the Australian context?

Refer sections 4.1 to 4.7 of this submission in which discuss other aspects of the taxation of savings.

# 5: General business tax issues

**Our submission comments below on the following discussion question in the TDP:**

24. How important is Australia's corporate tax rate in attracting foreign investment? How should Australia respond to the global trend of reduced corporate tax rates?

## 5.1 The importance of Australia's corporate tax rate in attracting foreign investment

As noted in the TDP, Australia's company tax rate is high by OECD standards, particularly given that many other countries have substantially reduced their corporate tax rates. There are also many nations in our region with lower rates.

But Australia's heavy reliance on company tax revenue (as compared to comparable jurisdictions) means that it is difficult for our Government to contemplate a substantial rate reduction, particularly in view of the benefit which would be obtained by non-residents on their existing investments.

This was acknowledged by the Henry Tax Review when it recommended[35] that 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*." [Emphasis added]

The accompanying aspect of this recommendation – that improved arrangements for charging for the use of non-renewable resources be introduced at the same time – died with the repeal of the mining resource rent tax.

As noted by the Deputy Secretary, Revenue Group, Rob Heferen[36] however, there are several adverse consequences of having a high company tax rate. Australia loses economic value because some investment opportunities become unviable (a particular concern for an open, capital importing economy such as Australia's, where the investors, especially foreign investors, can easily decide to allocate their capital to opportunities in other jurisdictions).

Higher levels of investment should increase the capital available for existing labour and increase labour productivity, with beneficial impacts on the demand for labour and consumption.

In short, a lower company tax rate should increase the prosperity of Australian workers.

The Government cannot keep procrastinating about whether and when to reduce its corporate tax rate, as it watches our nation's competitive position slip lower and lower.

A corporate tax rate reduction road-map is at least required so that businesses can see the tax reform direction in which we are headed and starting planning their investments accordingly.

[35] Henry Tax Review (2009), Recommendation 27.

[36] Rob Heferen, Address to the Minerals Council of Australia Biennial Tax Conference, Melbourne, 26 March 2015.

**Our submission comments below on the following discussion questions in the TDP:**

25. Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?
26. To what extent would Australia benefit from the mutual recognition of imputation credits between Australia and New Zealand?

## 5.2 Dividend imputation

CA ANZ remains of the view we expressed to the Henry Tax Review on dividend imputation[37].

The most vocal proponents for dismantling the dividend imputation system appear to be advocates for two groups which gain little or no benefit from the regime yet benefit from other features of our tax system:

- Inbound corporate investors
  But we would point out that such companies should pay company tax here if they profit from our country, and any Australian company tax paid is generally creditable in their home jurisdiction. In many cases, Australia no longer levies dividend withholding taxes on dividend paid to non-resident shareholders (either because the dividends are fully franked, or no withholding applies because of a relevant double tax treaty).

- Outbound corporate investors
  But we would point out that, for active offshore operations, Australia exempts both foreign income and capital gains, and allows such companies to repatriate dividends tax free. Alternatively, such profits can legitimately remain offshore for reinvestment or acquisitions. From a shareholder perspective, such Australian companies typically reflect a growth profile (as distinct from a high yield profile) which encourages further investment, and any such gains made by resident individuals and funds usually qualify for a CGT discount (ie dividend imputation is but one factor in shareholder decision-making).

These 'shareholder clientele' effects of dividend imputation were well recognised at the time dividend imputation was introduced[38].

Furthermore, dividend imputation is now a well-entrenched feature of the Australian economy.

During the Henry Tax Review consultation process for example, the then Treasurer Mr Swan indicated his support for the role dividend imputation played in the economy[39]. This was in response to concerns expressed by a range of stakeholder groups, including National Seniors and funds management associations. Since then, one can safely assume that there are now even more voices which would oppose major changes to dividend imputation, particularly in the rapidly growing SMSF sector. Indeed many Australians are increasingly aware that their industry or retail superannuation fund benefits from dividend imputation.

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[37] Section 6: An assessment of Australia's dividend imputation system. *Thinking Beyond Borders – Tax Reform for the 21st Century*, A Joint submission by KPMG and the Institute of Chartered Accountants in Australia to the Australia's Future Tax System Review.

[38] For example, see Professor John Prebble, *The Taxation of Companies and Corporate Investors*, Butterworths, Wellington, 1984.

[39] Wayne Swan MP and Treasurer, statement to the media, 22 April 2009.

The dividend imputation system has been an important part of Australia's corporate tax system and has served Australia well in the past. Although there are competing views as to its future, we do not believe that a compelling case for its abolition has not yet been made.

## 5.3 Trans-Tasman aspects of dividend imputation

As trans-Tasman organisation, our members have a strong interest in the benefits which would flow from greater economic harmonisation between Australia and New Zealand.

But mutual recognition of trans-Tasman franking credits has been on the agenda now for over twenty years. To date, the only policy change which has been achieved is the limited recognition in 'triangular' tax situations, where there are tax credits in both directions.

At a governmental level, this topic should be addressed once and for all in the context of the Closer Economic Relations framework. New Zealand has raised the topic often and deserves a final, considered policy response from the Australian Government.

The TDP indicates that Australia's lack of support for this measure results from Treasury modelling which indicates that mutual recognition would be detrimental to the Australian tax base. On the other hand, modelling by the New Zealand Institute of Economic Research and Centre for Independent Economics indicates there would be net benefits for both countries[40].

Perhaps the Henry Tax Review was close to the mark in its Final Report, where it said[41]:

> To further economic integration, consideration could be given to the appropriate degree of harmonisation of business income tax arrangements between the two countries, *with bilateral mutual recognition [of franking credits] only one element of this broad consideration*. [Emphasis added]

As noted in the TDP, a joint 2012 report by the Productivity Commissions of Australia and New Zealand last examined this issue and identified both benefits and risks.

As part of the Green Paper, the Government should give a final view on the issue of mutual recognition of franking credits.

If however there are other business tax integration issues which Australia feels need to be addressed before it would embrace mutual recognition, these issues should be explicitly stated so that organisations such as CA ANZ can undertake further work towards the goal of economic harmonisation.

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[40] John Ballingall and Chris Nixon, *The costs and benefits of mutual recognition of imputation and franking credits*, *A report for Business* NZ. New Zealand Institute of Economic Research, September 2012

[41] Henry Tax Review, Final Report, para 5.2.

**Our submission comments below on the following discussion questions in the TDP:**

27. To what extent does the tax treatment of capital assets affect the level or composition of investment? Would alternative approaches be preferable and, if so, why?
28. How complex is the tax treatment of capital assets and are the costs of compliance significant?

## 5.4 Embedding simple tax write-off thresholds in the income tax legislation

Capital allowance calculations and the capital v's revenue distinction can give rise to complexity for taxpayers.

We welcome the 2015 Federal Budget decision for an instant asset write-off for small business assets costing less than $20,000 and fast tax write-offs for the primary production sector.

Although we understand the economic thinking behind the temporary nature of this particular small business write-off, we believe that such treatment (albeit with a much more modest threshold) should be made a permanent feature of the income tax rules dealing with capital allowances for all business taxpayer categories. Depending on Treasury costings, some increase could hopefully be made on the current $1,000 general entitlement cap.

We see opportunities for similar approaches elsewhere as well - for example by treating all legal expenses less than $10,000 on revenue account and deductible (this is the approach under New Zealand income tax law).

An immediate write-off under the capital allowance provisions should be available for all businesses, with Treasury modelling to determine whether the current $1,000 limit can be increased.

Capital v's revenue distinctions could be removed for specified types of expenditure less than a set amount.

**Our submission comments below on the following discussion question in the TDP:**

29. To what extent does the tax treatment of losses discourage risk-taking and innovation and hinder businesses restructuring? Would alternative approaches be preferable and, if so, why?

## 5.5 Tax treatment of losses

Both the RBT, and the more recent BTWG in its Final Report on the tax treatment of losses acknowledged that the current tax treatment of losses discouraged risk taking and that the limitations on the use of losses may, in particular, disadvantage small businesses which typically do not have a diversified income stream and firms engaged in risky investments.

CA ANZ agrees.

The RBT did not attempt to fully evaluate all options for improving loss arrangements which would be dependent on, amongst other things, the outcome of its other recommendations. However, to limit the bias against risk taking and improve the ability of the tax system to serve as an automatic stabiliser during a downturn, the RBT recommended that 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.

For the same reasons, the BTWG recommended the introduction of loss carry back rules. Constrained as it was by revenue concerns, its preferred model envisaged a two year loss carry back period for revenue losses of companies, refunds limited to a company's franking account balance and a cap of $1 million on losses available to be carried back. Its target was small to medium companies.

In relation to the loss carry forward rules more generally, the RBT noted that there may be merit in reviewing the COT and the SBT to give greater weight to simplicity and certainty objectives (as opposed to revenue protection).

The BTWG also revisited the existing carry forward loss rules. It recognised that the SBT is an imprecise tool for distinguishing between legitimate changes to the business of an unprofitable company and loss-trafficking (ie changes that result from an attempt by a profitable company to use the losses of the unprofitable company to shelter its own income from tax).

It should also be acknowledged that, because listed and widely held companies have access to simplified ownership tracing rules which make it easier for them to pass COT, SBT compliance issues are now encountered more often in private groups.

The BTWG saw merit in a model that included:

- Retention of the COT;
- Modifying the SBT so that it aligns with the modern business environment by relaxing the positive limb of the SBT and removing the negative limbs (ie the new business and new transactions tests, and
- Rather than satisfying the SBT, allowing companies the option of 'drip feeding' losses for up to 10 years.

A combination of loss carry back rules and better targeted integrity rules for the carrying forward of losses was considered by the BTWG as more likely to influence risk taking and innovation than the indexation of carry forward losses.

The BTWG parked for consideration at a later stage or as part of a separate review extending the loss carry back rules to other entities, revisiting the treatment of capital losses and reviewing the tax loss rules applicable to trusts.

The BTWG also recommended that the Government undertake further work to develop a model for reforming the SBT and a more extensive assessment of the costs and benefits of such reforms.

Loss carry back tax offset rules were introduced by the former Government and first applied to the 2012-13 income year. However, being funded by the mining tax, they were repealed by the Government. As a consequence, the loss carry-back tax offset could generally only be claimed for that income year.

Although lower on the priority list, CAs have regularly raised with us concerns about the:

- Trust loss rules – these are extremely complex, and should be re-written into the ITAA 1997

- The family trust rules – a family trust election impacts the ability of a discretionary trust to carry forward losses and are also considered to be overly complex and in need of a re-write.

CA ANZ supports the reintroduction of loss carry back rules for companies. However, we acknowledge that the exact scope of this measure, including the period of carry back and maximum cap, would need to be tailored to take into account current budgetary constraints.

We also consider that the Government should undertake further analysis of the costs and benefits of reforming the carry forward loss rules, with a particular focus on the SBT which currently can apply inappropriately to deny a deduction for revenue and capital losses (as well as bad debts and unrealised losses).

The work already done by the BTWG provides an ideal starting point. Any review should seek to simplify what are in our view overly complex rules with possibly an undue emphasis on tax integrity.

We also note that the proposed amendments to the COT rules for multiple share classes, first announced in the 2008-09 Budget and accepted by the Government as a measure which should proceed, remain outstanding. This measure affects numerous companies, both large and small. In particular we note that it is extremely common for private companies to have different classes of shares or shares which have discretionary entitlements to dividends and returns of capital. We recommend that priority be given to legislating this measure.

In due course, the trust loss and family trust provisions should be reviewed and re-written into the ITAA 1997.

**Our submission comments below on the following discussion question in the TDP:**
30. How could the current tax treatment of intangible assets be improved?

## 5.6 Tax treatment of intangibles

It is now fair to say that intangible assets are often the most valuable asset class held by major companies. The scope (definition) of such assets has expanded enormously in recent times – particularly the USA concept of what constitutes intellectual property. Intangible assets are highly mobile, and some nations have implemented patent box regimes to encourage companies to locate such assets in their jurisdiction: other countries simply offer general low tax concessions.

The arm’s length nature of royalties and other charges made for the use of such assets often attracts disputes with revenue agencies. And those countries which hold most of the world’s intellectual property have negotiated down the tax treaty withholding tax rates applicable to royalties (typically to 5%).

Put simply, intangibles are (and should be) a key focus of tax agencies and tax policy makers around the world.

Transfer pricing and intangibles is an important topic being considered by the OECD working party dealing with the BEPS Action Plan 8, and the final recommendations of this group will no doubt inform the thinking of the Australian Government on this aspect of tax reform.

The ATO is already a lead agency in the design and implementation of new OCED thinking in this area – such as the September 2014 revised *Guidance on Transfer Pricing Aspects of Intangibles*. The ATO is also heavily involved in the latest follow-up OECD project which is looking to update guidance on cost contribution agreements[42].

It seems to us that this is a tax topic area in which our community is highly reliant on the vigilance of the ATO, particularly in the areas of valuing intangible assets, transfer pricing and the identification and taxation of royalties paid to offshore jurisdictions. The ATO needs to have staff equipped with the high level skills needed to undertake this work, and this is perhaps an area where there is a case for differential public sector pay rates (or an expanded agency budget to hire suitably qualified consultants if necessary).

In terms of tax policy:

- Australia could explore the concept of a patent box regime for 'home grown' R&D supported intellectual property using the model recently negotiated between the United Kingdom and Germany[43].
- The current tax concept of 'royalty' should be expanded, in both a domestic and tax treaty context to reflect the broader concepts of intellectual property recognised for commercial purposes in jurisdictions such as the USA (eg some tax treaties make specific provision for withholding on 'technical fees', eg the Double Tax Agreement between Ireland and Vietnam).
- ATO advice should be obtained on the extent to which it is concerned about the use of separate agreements for the provision of services (no withholding tax) and the payment of royalties (withholding applies). Any concerns raised could lead to further deliberations on the need for a broad non-resident contractor withholding tax: New Zealand provides a model for such a tax (we appreciate that this is a long term project requiring careful consideration of our tax treaty obligations but the cause of change may be pushed along by the OECD's final BEPS recommendations).
- At the risk of raising concerns over trade barriers disguised as tax integrity measures and our obligations under Intellectual Property Conventions, our recent submission to the Senate Standing Committee on Economics Inquiry into Corporate Tax Avoidance put forward for consideration a national franchise model in which access to the Australian market could somehow be made conditional on tax compliant behaviour by multinational companies in areas such as the transfer pricing of intangible assets. We gave as examples eligibility for:
  - Government contracts and licences
  - Government subsidies
  - Legal protections afforded to those selling goods and services
  - Foreign Investment Board approval

Because of the enormous value now attributable to many types of intellectual property, CA ANZ sees intangible property as a key area of tax reform.

Given that the final BEPS recommendations are only a short time away, the development of policy in Australia should take account of the OCED's final recommendations on those Action Plans (particularly Action Plan 8) which deal with intangibles.

[42] OECD Public Discussion Draft, *BEPS Action 8: Revisions to Chapter VII of the Transfer Pricing Guidelines on Cost Contribution Arrangements (CCAs)*, 29 April 2015 – 29 May 2015.
[43] Refer: https://www.gov.uk/corporation-tax-the-patent-box

Consideration should be given to whether:

- An Australian patent box regime should be developed for home grown, R&D supported intellectual property
- Tax compliant behaviour, particularly in areas of transfer pricing and the setting of royalty rates, could become a pre-requisite for multinationals wishing to undertake economic activity in Australia (eg in terms of government contracts or licences, subsidies etc.).
- The current tax concept of 'royalty' could be expanded so that it applies to a greater range of offshore entities who provide knowledge, skills and services to Australian businesses.

**Our submission comments below on the following discussion question in the TDP:**

31. To what extent should the tax system be designed to attract particular forms of inbound investment (for example, by distinguishing between active and passive or portfolio and non-portfolio)? If so, what principles should inform this?

## 5.7 Attracting inbound investment

Australia is a relatively small open economy which is heavily dependent on cross-border flows of inward investment and outward supplies of goods and services for its economic prosperity.

Although not determinative, tax does have a substantial impact on investment decisions.

That said, Australia already provides a wide range of income tax concessions designed to attract inbound investment (eg competitive withholding rates, a conduit foreign income regime, CGT exposure restricted to Australian land and assets used in connection with a permanent establishment). The personal income tax and FBT rules seek to make things easier for expatriate employees to work here (with the exception of the living away from home allowance). Foreign Investment Review Board approvals for foreign investors are, in most cases, granted. And State governments sometimes provide tax-related incentives.

Other parts of our submission address those areas most commonly cited as tax barriers to inbound investment, being:

- A comparatively high general company tax rate
- A dividend imputation system with a domestic bias.

Recent changes to the income tax law have sought to address tax base erosion and profit shifting (eg thin capitalisation amendments and the tax integrity measures announced in the 2015 Federal Budget), and more changes are expected once OECD recommendations are finalised. CA ANZ will continue to work closely with Treasury on the ramifications of those recommendations for Australia. We know Treasury is extremely conscious of the need for Australia to take a considered view of whether the OECD recommendations are in the national interest, and embrace multi-lateral (as distinct from unilateral) approaches.

The last major review of Australia's international tax arrangements was conducted by the Board of Taxation with its report completed in February 2003[44]. Many important policy changes were implemented as a result.

[44] Board of Taxation, *Review of International Tax Arrangements*, 2003 and Government response. Source: http://www.taxboard.gov.au/content/content.aspx?doc=reviews_and_consultations/international_taxation_arrangements/default.htm&pageid=007

More recently, Australia has progressed tax measures such as the Investment Manager Regime and the phased introduction of Managed Investment Trust rules.

The focus on managed funds is partly driven by the fact that financial services is one of the key areas of endeavour in which Australia has been identified as having a competitive advantage. There remain however strong views within this sector that there is still more to be done on the tax front to improve Australia's standing as a financial services centre. Areas of the tax law often cited in this context include:

- The treatment of foreign bank branches (there are also competition benefits to be gained here) and improvements to the offshore banking regime
- Reductions in interest withholding tax for financial institutions

## 5.8 A passive v's active company distinction in a domestic context – companies (other than collective investment vehicles)

To date, the concept of passive v's active income, and portfolio and non-portfolio stakeholders, has been found mainly in Australia's income tax treatment of outbound investment (eg controlled foreign companies and foreign branches, repatriation of foreign dividends).

The fact that the TDP has raised this as an issue for inbound investment may prompt a discussion about whether Australia should consider incentives such as a lower company tax rate only for companies (whether domestic and foreign owned) which undertake activities beneficial in terms of domestic investment, growth and employment[45]. We hasten to add however that, apart from the tax rate, other key tax-related determinants of company behaviour are the tax base (affecting the effective tax rate) and tax complexity.

Note that the focus on tax rates here is confined to companies due to the fact that company taxes are generally considered most 'harmful' to economic growth[46].

To some extent, Australia has already started down the path of multiple company tax rates with the recent 2015 Federal Budget decision to tax small *business* companies at 28.5% and leaving the general rate at 30%. Small passive investment companies do not qualify for the lower rate. In an economic sense, this is a domestic stimulus measure.

But there is also some literature supporting the view that differential tax rates may be beneficial and indeed justifiable to attract foreign investment (as distinct from a harmful 'race to the bottom') when used to address a country's special economic and geographic characteristics[47]. This is the argument used by Ireland, which casts itself as a 'peripheral' country with circumstances not encountered by centrally located European countries.

In an Australian context for example, one strand of this argument would be that we are now a deindustrialised economy on the edge of the high growth Asian region that needs to move away from a dependency on mining and extractive industries towards those sectors that play to our strengths.

[45] We have assumed here that any lower company tax rate for 'active' businesses would apply across the board, rather than an Australia offering a favourable tax regime only for inbound investors.
[46] Johansson, Heady, Arnold, Brys and Vartia, 2008. Their work shows that some taxes are more harmful than others to economic growth (measured as GDP per capita). From most to least harmful, these are: corporate income, personal income, consumption and property taxes. If tax competition encourages lower company taxes, the other taxes that may be increased to provide alternative revenue sources are considered less harmful to overall economic growth.
[47] Baldwin and Krugman (2004).

Although Ireland is often singled out as an unfair tax competitor, its well publicised 12.5% company tax rate only applies to trading activity[48], with a 25% rate applicable to other companies (including those engaged in oil and gas extraction[49]). No distinction is made between small and large, domestic or multinational companies.

Although a domestic distinction between passive and active companies would add some complexity to the law, the concept of a 'passive' company taxed at the higher rate does advance the cause of equity because it partially addresses concerns about the use of companies (particularly private companies) to warehouse passive income at the company rate.

## 5.9 A passive v's active company distinction in a domestic context – collective investment vehicles

In the context of collective investment vehicles, the recently published Board of Taxation review of tax arrangements applying to collective investment vehicles canvasses whether flow-through taxation treatment should be provided to achieve a tax neutral outcome for inbound investors, where the activity is limited primarily to passive investments.

This idea builds on a range of current tax concessions designed to grow Australia's financial services sector and make us more competitive with other countries, particularly Singapore.

Although we have not had sufficient time to fully consider the Board's report, we understand that the recommendations will be considered as part of the tax reform process.

CA ANZ sees merit in further design work on an inbound investment strategy which provides incentives for those sectors in which our country has a natural advantage, or the talents to build.

In terms of concepts such as passive v's active, we see an opportunity for a much broader discussion with Treasury about:

- our corporate tax rate settings, and
- the expansion of current concessions to make Australia a more attractive location for collective investment vehicles.

[48] Refer guidance from Irish Tax and Customs on what constitutes trading: Guidance on Revenue opinions on classification of activities as trading and Determination of Classification as Trading Activity list

[49] This is noteworthy in terms of whether companies operating in the Australian mining and extractive sector should pay a higher company tax rate as a proxy for economic rent.

**Our submission comments below on the following discussion questions in the TDP:**

32. To what extent does the tax treatment of foreign income distort investment decisions?
33. To what extent should the tax system be designed to encourage particular forms of outbound investment (for example, by distinguishing between active and passive or portfolio and non-portfolio)? If so, what principles should inform this?

## 5.10 Tax treatment of foreign income

Refer section 5.2 in this submission for our comments on the domestic bias implicit in the dividend imputation system.

In terms of other aspects of the income tax law, our current tax rules already provide substantial support to those Australian companies which invest offshore.

The CFC provisions, although complex, have been mastered by specialists in the field of international tax. They are however far too complex for taxpayers and the average tax professional and, as a low order priority, should be re-written and moved into the ITAA 1997 after the Government has considered the OECD's BEPS recommendations for Action Plan 3 (strengthening the CFC rules).

The absence of any foreign investment fund legislation and deemed present entitlement rules (sections 96B and 96C ITAA 1936) since 2010-11 appears not to have attracted any undue concern from tax policy makers. This reflects a view that the FIF legislation was unnecessarily complex and had little effect on the integrity of the law. Transferor trust measures remain in place however, and provide a useful weapon against those who seek to establish offshore trust structures.

The most recent reform efforts in the international tax area involved the release of exposure draft legislation in February 2011 for a proposed new foreign source income deferral rule (dealing in particular with foreign accumulation funds and modernizing the CFC provisions).

## 5.11 Encouraging outbound investment

Refer section 5.2 in this submission our comments on the domestic bias implicit in the dividend imputation system.

CA ANZ agrees with the existing policy of taxing business income from foreign jurisdictions on the basis of whether that income in passive or active.

On the other hand, passive investment abroad should not be favoured over passive investment in Australia (capital export neutrality). This principle is entrenched in Australia's CFC rules. We note that the settings in those rules for what is defined in passive and active is also part of the OECD's BEPS Action Plan 3 on CFCs.

CA ANZ is also very supportive of the government's commitment to revising old tax treaties as well as exploring opportunities to negotiate new treaties, particularly with new and emerging market countries[50]. Our understanding is that the multi-lateral instrument approach to amending Australia's existing treaties should not unduly disrupt treaty negotiation processes.

[50] CA ANZ submission to Treasury on tax treaties, 8 August 2014.

CA ANZ suggests that:

- Further work on the CFC legislation be revisited once the Government has considered the OECD's BEPS recommendations for Action Plan 3.
- The OECD BEPS process should not slow Australia's program to enter into new or revised double tax agreements.

**Our submission comments below on the following discussion question in the TDP:**

34. How can tax avoidance practices such as transfer pricing be addressed without imposing an excessive regulatory burden and discouraging investment?

## 5.12 Transfer pricing

The Government recently announced that it will implement the OECD's Country by Country (CbC) reporting for multinational enterprises with substantial global revenue.

Although this will place a burden on such groups, the reporting will lead to greater transparency of a multinational company's operations, including where income is reported, tax paid and employees located. As CbC reporting is a BEPS initiative that has been endorsed by the G20, it is questionable whether it will have a negative impact on foreign direct investment given that Australia's major sources of direct foreign investment are from nations which have (or are likely to) embrace this measure.

In other words, added complexity and compliance costs is seemingly a cross all large multinationals must bear.

At the other end of the business spectrum however, transfer pricing can place a disproportionately high burden on small and medium size businesses. CA ANZ is supportive of recent ATO administrative safe harbours from transfer pricing documentation requirements including those for small business taxpayers.

However, our view is that consideration should be given to carving out SME taxpayers entirely out of the transfer pricing rules as other jurisdictions such as the UK have done.

Consideration should be given to whether Australia can identify low risk SMEs (or low risk SME transactions) which can be carved out of the transfer pricing regime.

CA ANZ would be happy to work with Treasury and ATO officials on suitable safeguards.

**Our submission comments below on the following discussion question in the TDP:**

35. Should the tax system provide a more neutral treatment of different financing arrangements (debt, equity and retained earnings), and if so, how? What principles should inform the approaches?

## 5.13 More neutral treatment of financing

These issues were explored by both the Henry Tax Review and the Business Taxes Working Group.

We suggest that this research be revisited once Treasury and the Government have considered fundamental design features of our tax system, such as the future of dividend imputation and the aspirational company tax rate which Australia should implement over time.

In terms of lessons learned from the Henry Tax Review, our sense is that the allowance for corporate equity (ACE) model was too novel an idea to be embraced with broad support from the corporate community. The transitional effects were particularly problematic. A lower company tax rate remains our preferred policy response to reducing the attractiveness of corporate debt financing.

We have similar concerns about the cash flow tax regime considered as part of the Henry Tax Review deliberations, with this approach also giving rise to foreign tax credit eligibility concerns in the home country of an inbound investor.

**Our submission comments below on the following discussion question in the TDP:**

36. Should the tax system provide a more neutral treatment of income earned on revenue account and capital account? Does the distinction create significant compliance costs for business and, if so, how could it be simplified?

## 5.14 The capital – revenue distinction

The capital-revenue distinction has long been a difficult aspect of our income tax law. Much depends on the intention of the taxpayer at the time of acquiring the asset, and many have struggled with the subjective nature of this test.

The distinction should remain however, for various reasons:

- Many jurisdictions provide concessional treatment to assets held on capital account, recognising the need to reward risk-taking behaviour or patient investors in longer term projects (the "investment culture" argument of the Ralph Review of Business Taxation). Our tax system should remain internationally competitive in this respect.
- Special tax rate calculation rules typically apply to capital gains to reduce the impact that a large, one-off recept has on tax payable (the bunching effect). Even if the capital-revenue distinction was removed, it would seem necessary to replace it with an averaging mechanism for designated transactions and circumstances, making it still necessary to identify eligible gains made on capital account.
- The treatment of CGT assets held for less than a year effectively puts short-term gains on the same footing as ordinary income without an overly burdensome lock-in period.
- CGT rollovers have been crafted to facilitate desirable restructuring in certain situations, and similar concessions would be needed if income treatment applied.
- Assuming no change in Government policy to date, provisions would also need to be crafted to identify those situations where realisation of gains should not occur on death.
- The implication that capital losses could be set against ordinary income profits would need to be carefully costed, and there could well be difficulties and unpredictable consequences for both taxpayers and the ATO.

Nonetheless, here are some ideas which might be considered to reduce the complexity and compliance costs associated with the capital – revenue distinction. Our submission has already alluded to the possibility of a reduced discount factor for capital gains made by resident individual taxpayers.

## 5.15 Alternative approaches

### 5.15.1 Taxpayer identification of asset category at the time of acquisition

One simple, compliance cost-saving approach might be to require taxpayers to make a determination at the time an asset is acquired as to whether that asset is held on capital or revenue account. Tax categorisation of an asset as trading stock could also be made clear from the outset.

As now, a change of circumstances in asset holding would trigger a liability (ie where an asset which was originally a capital asset may be converted into a revenue asset and vice versa).

### 5.15.2 Should we continue to recognise pre-CGT assets in private companies?

Our income tax law still provides numerous examples which recognise the 'pre' and 'post' status of CGT assets – ie assets acquired on or before, or after, 19 September 1985, the date when CGT was introduced.

For assets held by listed companies however, the distinction was effectively abandoned because of stricter change of ownership testing requirements introduced in 1999.

However, the preservation of pre-CGT asset status remains as an important factor which impacts the decision-making of those private companies who have been able to assert that majority underlying interests continue to be held by ultimate owners who held their interests immediately before 20 September 1995. Private companies are unique in that the death of a shareholder and the passing of the deceased's shares to another does not trigger a change of ownership. Shares transferred as a result of relationship breakdowns are similarly treated.

Nearly 30 years after the introduction of CGT, and as part of the trade-off for lower company tax rates and the removal of complexity from the income tax law, now may be an opportune time to consider bringing all pre-CGT assets held by private companies into the CGT net[51].

If such a policy was adopted, a valuation period would need to be made available to determine the market value cost base of the asset for future tax calculation purposes.

As part of the trade-offs set out in the Green Paper for a corporate tax rate reduction roadmap and to reduce complexity, consideration could be the given to:

- 'up-front' asset categorisation for tax purposes, and
- the impact of removing pre-CGT asset status for private company assets (with those assets so brought into the CGT net given a market value cost base).

**Our submission does not comment on the following discussion question in the TDP:**

37. Are there other important issues in the business tax system, not covered in this section, which should be considered as part of the Tax White Paper process?

[51] Henry Tax Review (2009). Recommendation 17(c), although this relates to all taxpayer segments.

**Our submission does not comment on the following discussion question in the TDP:**

38. In what circumstances is it appropriate for certain types of businesses to be subject to special provisions? How can special treatment be balanced with the goal of a fair and simple tax system?

**Our submission comments below on the following discussion question in the TDP:**

39. Does the R&D tax incentive encourage companies to conduct R&D activities that would otherwise not be conducted in the absence of government support? Would alternative approaches better achieve this objective and, if so, how?

## 5.16 Research and Development

The government has recognised the need for Australia to move from a resource-based to a knowledge-based economy. Our three key general comments concerning the R&D tax incentive are:

- The R&D tax incentive, being a broad-based, economy-wide incentive, is the central plank of Australia's innovation policy. Encouraging innovation is an essential ingredient for Australia to develop a "knowledge economy" that is globally competitive into the future, particularly given the increasingly mobile nature of R&D expertise and venture capital. We therefore believe that maintaining and indeed strengthening the benefits of the R&D tax incentive is vital for ensuring that innovative projects are undertaken, and that they are undertaken in Australia. We provide further brief comments on this below.
- The R&D tax incentive alone is not sufficient to foster innovation. Australia's innovation policy should comprise a range of different forms of support, including tax incentives and grants programs to build skills and support commercialisation, provided they are appropriately targeted.
- Opportunities exist to further refine the design and operation of the R&D tax incentive to optimise the outcomes it is capable of delivering. These include:
  - Offering a rate that is sufficiently generous to attract foreign investment in comparison to overseas countries that offer increasingly generous incentives. Australia's R&D benefit now lags behind that offered by many other countries, and that stands to worsen further if the proposed 1.5% cuts to the R&D incentive rates are legislated. We caution the government to reconsider these cuts, and urge it to retain at least the current rates so the incentive continues to deliver the benefit that the incentive was originally designed to offer. So too, offering a stable and secure R&D incentive that sends a message of 'investment grade certainty' to Australian and international R&D investors is also essential if Australia is to remain attractive as a destination for making long-term R&D investment decisions.

    We note that a formal post-implementation review of the R&D tax incentive is currently underway, and recommend that no detrimental changes be made to the incentive until the review has been completed and we have a proper full assessment of its performance on which to base R&D policy reform decisions.
  - The opportunities to use the R&D tax incentive as a lever to foster the creation of entirely new industries and technologies in Australia that are fit for purpose in a carbon constrained world, are immense. Australia has the potential to transform its economy to one that offers innovative emission reduction solutions and

technologies, particularly to emerging markets in energy-hungry nations such as China and India. We note the G7's massive pledge this week to completely decarbonise the world's economy by 2100 (net zero emissions), with cuts between 40-70% by 2050. We believe the government should consider how the R&D tax incentive could be enhanced to offer additional R&D tax incentive rates to attract this kind of world-leading innovation to Australia. Australia could become the hub or destination of choice for developing cutting-edge green technologies and associated intellectual property, from renewable energy inventions, to energy efficiency, to carbon capture and storage technologies.

  - Introducing quarterly R&D instalments to give start-up businesses more timely access to the cashflow benefits of the refundable R&D tax incentive. We recommend that this measure be reconsidered and implemented as a measure to further assist small businesses.

As to the specific question posed in the TDP, our comments are:

- For small companies – there appears to be strong evidence from the case studies and Australia's R&D success stories that the R&D tax incentive supports R&D activities and expenditure by start-up companies that otherwise would not occur. Also, that it provides vital public investment in innovations that benefit the economy and society which may not otherwise have been invented. However, the incentive for small companies needs to be refundable to deliver its greatest benefit, when vital working capital is constrained and cashflow is very limited in the early years. We encourage the government to retain this vital refundable feature of the R&D tax incentive for companies with turnover up to $20 million.
- For large companies – the research shows that there is a strong correlation between government support for R&D and growth in GDP. Even if it is uncertain whether the R&D Tax Incentive encourages Australia's largest companies to conduct more R&D activities than they otherwise would have, it certainly encourages them to undertake those R&D activities in Australia (either directly or through contracted R&D with enterprises in Australia including small and medium enterprises), as Telstra has persuasively argued.[52] Those R&D activities in Australia create jobs that may otherwise have been located overseas, which results in taxable earnings (salaries and wages of employees) and ultimately in taxable profits of companies in Australia, all of which grows Australia's economy.
- One of the key messages from the OECD Science, Technology and Industry Scoreboard 2013 report, based on internationally comparable data, is that investment in innovation remains a priority, primarily through measures that support R&D, for countries seeking to overcome the effects of recent financial and economic downturns.
- The European Commission's 2014 Report argues that the vast majority of studies reviewed conclude that R&D tax credits are effective in stimulating investment in R&D. Also, countries without market intervention are likely to generate less innovation than would be socially desirable.
- Most recently, UK HM Revenue and Customs report, *Evaluation of Research and Development Tax Credit* [53], issued in March 2015, states that their econometric analysis of additionality indicates "that for each £1 of tax foregone, between £1.53 and £2.35 of R&D expenditure is stimulated... Even the low-end result represents a good level of additionality".

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52 Telstra, 2014, Submission to Senate Standing Committees on Economics in relation to Tax Laws Amendment (Research and Development) Bill 2013 Submission 14, p.2.

53 Kringelholt Fowkes R., Sousa J. and Duncan N., HM Revenue and Customs, London, March 2015 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413629/HMRC_WorkingPaper_17_R_D_Evaluation_Final.pdf

**Our submission comments below on the following discussion question in the TDP:**

40. What other taxation incentives, including changes to existing measures, are appropriate to encourage investment in innovation and entrepreneurship?

## 5.17 Encouraging investment in innovation and entrepreneurship

Refer later comments relating to small business on whether tax policies targeting SMEs should be more oriented to innovation and growth in the sector, as distinct from simply providing tax concessions to businesses that start small and stay that way.

We have also received some feedback that existing initiatives for Early Stage Venture Capital Limited Partnerships and Venture Capital Limited Partnerships are not working as well as they could, and note that industry associations such as Australian Private Equity and Venture Capital Association Limited have also called for a review.

# 6: Small business

## 6.1 What role does small business play in the Australian economy?

Australia's small business sector is an incredibly diverse group.

It ranges from micro businesses which could almost be described as hobbies, to independent contractors, to local retail shops, to medium sized operations that employ a substantial number of people.  It traverses a whole range of industries and business in all segments of the business life cycle.

Some small businesses provide the ways for many citizens to gain employment (eg in the construction industry), others are budding start-ups and some are continuing a long-standing family business.

A well-worn cliché in political circles is that small businesses are the 'engine room' of the economy.  In support of this it is often noted[54] that:

- Small business represents 97.38% of all businesses in industry
- Small business contributed around 33% of private industry value added in 2012-13
- Small businesses employed around 4.5 million people in 2012-13, approximately 43% of private sector employment, and
- 18,368 small exporters shipped goods to the value of $1.3 billion in 2012-13. This represents 42.7% of all goods exporters and 0.5% of the total value of all goods exported.

These percentages are substantial.  However, what they also demonstrate is that small business is not as productive as it could be. This is a major issue given that Australia needs to dramatically improve its future productivity in order for living standards to be maintained.

As noted by the then Treasury Secretary[55]:

> "The challenge of improving multifactor productivity growth is important across all areas of the economy, but is particularly evident in Australia's small business sector. Small businesses employ around 43 per cent of the private sector workforce, but are responsible for only 34 per cent of private-sector output.  Going forward, it will be important to put in place the broad frameworks to facilitate small business productivity, and to remove any impediments to small business innovation and growth   When small business management practices are compared with those in other countries, Australia ranks well below the best performers such as the United States, Germany and Sweden— see Green, R (2009) Management matters in Australia: just how productive are we?, Report commissioned by the Department of Innovation, Industry, Science and Research."

Helping small businesses become more productive through improved management practices could, from a tax perspective, be achieved by assisting them transition to modern business systems, e-government and streamlined compliance. This would involve making accounting and tax easier through the adoption of technological solutions which leave business owners more time to focus on their business.

[54] Source: http://treasury.gov.au/PublicationsAndMedia/Publications/2012/sml-bus-data
[55] The 2014-15 Budget and Sustaining Broad Based Growth in Living Standards, Speech to the Australian Business Economists, Dr Martin Parkinson, 20 May 2014.

## 6.2 Compliance costs

There is no question that compliance costs are greater for small business and that this may be one of many contributing factors to their lower productivity.

In this regard, the TDP reiterates that the Government is committed to reducing the regulatory burden facing all Australian businesses, including small business. Tax is just one element of the broader regulatory environment small business must navigate.

The Chartered Accountants ANZ latest sponsored research on tax compliance costs for SMEs in Australia was undertaken as part of an Australian Research Council Linkage project on tax system complexity, with a multi-university team lead by The University of New South Wales. It concluded that "while business size is the main factor in determining the magnitude of tax compliance costs at firm level, the number of taxes (both federal and state) is also a significant determinant irrespective of firm size. In addition, there is a clear perception among SMEs that the complexity of tax laws, the frequency of tax changes and the administrative requirements imposed by the ATO are significant drivers of tax compliance costs for their business."

Whether compliance costs should translate to a lower tax rate or special rules for small business need to be carefully tested. Such policies can sometimes create more work (particularly if they do not fit into natural accounting or tax systems) and add complexity – especially when they are frequently adjusted.

Our members also report that well-intended measures designed to help small business – such as the simplified tax system rules – have not been embraced because of the eligibility conditions associated with the measures and the difficulties encountered as a small business begins to grow and becomes more sophisticated.

Judith Freedman, an eminent UK tax economist who was heavily involved with the Mirrlees Review, has stated[56] that:

> "Small businesses are often seen as having special tax needs. There are frequently demands made on their behalf by pressure groups and politicians for special concessions, incentives and reliefs. … The result is far from simplification. Often layer upon layer of regulation adds elections and decisions for the smallest businesses to cope with. There is also consequent frequent change, which is inevitably burdensome and costly. It does not follow from the small size of a business that the affairs of that firm or the law applying to it are, or can be, simple. Small business affairs interact with those of the family and other personal relationships and they offer a way of life as well as a financial venture. They are inherently complex. Even if complete simplicity is unattainable, however, general stability and good tax structures will benefit all businesses, including small businesses for whom learning about and understanding change is particularly burdensome. *It may sometimes be the case that a reform that is argued to be needed for small businesses may be desirable for all. If that is the case then there are good grounds based on equity and allocation, as well as simplicity and definitional arguments, for not imposing restrictions by way of size*." (Emphasis added)

We agree, and consider that simplification proposals for small business should not be used as a substitute for simplifying the whole tax system. A recent example in an Australian context is the 100% write-off for depreciating assets costing less than a particular amount. In our view, all business taxpayers should enjoy this concession, set at a reasonable amount.

[56] Reforming the business tax system: does size matter? Fundamental issues in small business taxation, Judith Freeman, Published in Australian Business Tax Reform in Retrospect and Prospect, Thomson Reuters, 2009. Refer pages 155-156. Sourced from: http://www.law.ox.ac.uk/themes/tax/documents/Ref.Bus.Tax.03.09.09.pdf

Our organisation has been working closely with the ATO to reduce compliance costs for all. This ongoing work includes collaboration with the ATO's safe harbour committees.

Also, our view is that – over a suitable adjustment period – there are also valid tax policy reasons for closer alignment of all business tax payment arrangements (rather than maintaining the differentiation between businesses of different size). These include:

- Reducing the timeframe in which funds which rightly belong to others (eg PAYG withheld from employee pay packets and Superannuation Guarantee) are held by a small business
- Reducing the risk that such funds may be used inappropriately by the small business (eg to meet private expenses)
- Enabling the ATO to obtain better real-time data indicating whether a small business is experiencing difficulty in meeting its tax payment and lodgement obligations (ie warning signs)
- The impact of electronic remittance and lodgement procedures to streamline compliance
- To foster improved, efficient, business-like practices within the small business sector.

**Our submission comments below on the following discussion questions in the TDP:**

41. What effect is the tax system having on choice of business structure for small businesses?
42. What other options, such as a flow-through entity (like an S-Corporation), would decrease the overall complexity and costs for small business involved with choosing a business structure? How would such an entity provide a net benefit to small businesses?

## 6.3 The impact of the tax system on choice of business structure

The tax system is undoubtedly a key factor in choice of business structure – the reasons are alluded to in the TDP.

In particular, the taxation treatment of non-fixed trusts and beneficiaries and the difference between the top personal marginal tax rate and the company tax rate drive structuring decisions and tax planning for those with non-PAYG withholding income. Our dividend imputation system affects whether shareholders of a private company pay themselves in the form of salary or dividends.

The flexibility and financial outcomes available from tax effective structures does raise legitimate equity concerns vis-à-vis those who are unable (for example) to achieve income-splitting. However, the legal foundations of such structures are to be found in corporations law, partnership law and trust law – they are not creations of the tax law yet the tax law must cater for their specific features. There are also a myriad of other factors prompting the use of such structures, including the desire for limited liability, asset protection, the maintenance of family members and succession planning.

Of broader relevance, the tax system has become a very important factor for individuals choosing between employment and self-employment in the form of a contractor or via a personal services entity (although in some cases it is the payer who influences this decision – the "no ABN, no work" scenario).

### 6.3.1 Trusts

Trusts, especially discretionary trusts, are increasingly common in small business and professional practice structures. It is quite common for such trusts to be used in tandem with other entities, such as where shares in a private company are held by a discretionary trust to facilitate the streaming of franked distributions and gains (subject to tax safeguards such as the family trust election rules).

In recent years, the income tax law applicable to trusts has been complicated by several court decisions and consequential changes to the relevant legislation and ATO guidance.

The taxation of discretionary trusts in particular has been an issue for a number of years:

- In 1999 the Ralph Review of Business Taxation recommended that trusts be taxed as companies and the then-Treasurer Peter Costello, accepted the proposal. Draft entity tax was released for comment. However, the negative response meant that it was abandoned.
- The Henry Review recommended that the trust rules be updated and rewritten to reduce complexity and uncertainty around their application.
- On 21 November 2011, the then Assistant Treasurer released an initial consultation paper, *Modernising the taxation of trust income - options for reform*, which outlined three possible models for taxing trust income.
- On 23 October 2012 another policy paper was released "Taxation of trust income – options for reform". It further articulated the design of two models (which were renamed the economics benefits model' and the 'proportionate assessment model')[57].

Since then, there have been no further announcements.

In other areas – such as the tax treatment of managed investment trusts – slow progress has been made to improve the relevant tax law to make it suited to the commercial uses of such trusts.

Nonetheless, the number of substantive trust taxation reviews that have not progressed are indicative that fundamental reform is extremely difficult.

**Taxation of trusts**

Given the magnitude of other tax reform issues we are of the opinion that rather than attempting major changes in the area of trust taxation, a more limited approach towards fixing a number of particular trust issues should be adopted.

These issues have been catalogued over a number of years and have recently been the focus of two limited-life ATO consultation groups:

- Working Group 1: Closely-held trusts (including family discretionary trusts)
- Working Group 2: Widely- held trusts (including custodians)

We recommend that this work should be given formal support by Government and supervised by our proposed Tax Reform Commission. For widely-held trusts, the recently published Board of Taxation review of tax arrangements applying to collective investment vehicles contains useful insights.

[57] Refer: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/modernising-taxation

## 6.4 Look through entities

The TDP raises the prospect of a look-through, or flow through, entity.

Other countries which do not have trusts and/or dividend imputation have developed look through treatment for a variety of entity types. An example is the United States, with its S-Corporation. Under such regimes, instead of the entity being taxed, the tax effect of transactions 'flows through' to the ultimate owners of the entity. Essentially, this results in the operating entity being ignored for tax purposes. New Zealand, which does have a dividend imputation system, has a LTC regime.

Chartered Accountants, in association with Deloitte, considered a small business entity flow through taxation regime in 2008[58] and we expressed our in-principle support. We felt that such a regime would help those small businesses seeking corporate status and limited liability with flow through tax treatment.

Since then however, the Henry Review concluded that a flow-through regime for closely held companies and fixed trusts should not be adopted for the time being, but could be considered if Australia moved away from the dividend imputation system.[59]

We also note that there are many academic critiques of look through entities. These emphasise that look through entities add another layer of complexity and regulation, and generally suggest they would only be embraced by taxpayers if they provided additional tax savings to the current taxation system.

Finally, although New Zealand successfully implemented an LTC regime in 2010, the design phase was rushed and it seems fair to say that it has brought with it a number of problems which are still being worked through today in a bid to rectify various aspects of the regime. We also note the complications added to the New Zealand tax law because of the LTC provisions (eg on topics such as cessation of LTC status, losses and loss limitation rules, and disposition of look-through interests).

Given the Australian Government's emphasis on simplifying the tax law to minimise compliance costs and to make business easier in a climate of declining revenue, it seems to us that an LTC regime for closely held entities is unlikely to be supported by policy makers.

For collective investment vehicles which are widely held however, the recently published Board of Taxation review of tax arrangements applying to collective investment vehicles contains useful insights.

**Our submission comments below on the following discussion question in the TDP:**

43. Is the interaction of the personal and business tax systems a problem? What can be done to manage the personal-business tax interactions?

Refer to our response to question 40 (6.3).

[58] A joint report from the Institute of Chartered Accountants in Australia and Deloitte, Entity flow-through (EFT) submission, April 2008. Refer: http://www.charteredaccountants.com.au/~/media/Files/Industry%20topics/Tax/leadership%20papers%20and%20toolkits/entity_flowthrough_report.ashx

[59] Henry Tax Review (2009). Recommendation 38.

**Our submission comments below on the following discussion question in the TDP:**

44. What are the most significant drivers of tax law compliance activities and costs for small business?

## 6.5 The Chartered Accountants ANZ list of significant drivers of tax law compliance and cost for small business

Set out below is a summary prepared by the CA ANZ tax team on aspects of the tax law which are often raised with us as overly complex for small business.

| Income tax (Law) | Fringe Benefits Tax |
|---|---|
| • Employer – contractor distinction (also relevant to FBT, superannuation guarantee, payroll tax and workers compensation)<br>• Personal services income provisions<br>• CGT small business concessions<br>• Private companies:<br>  ○ Division 7A ITAA 1936 compliance<br>  ○ Anti-streaming rules<br>• Trust provisions and associated rules (eg family trust elections)<br>• Substantiation rules (partnerships and self-employed individuals) | • FBT is a 'drag net' tax – employers spend most of their efforts ensuring they qualify for the many exemptions<br>• Car fringe benefit calculations – complying with log book method requirements to prove car used mainly for business<br>• Expense payment benefits – proving that most expenses are in fact business related and attract no FBT<br>• Low value and In-house benefit concessions – tracking eligibility<br>• Taxable benefit calculation and reportable benefits |
| **Income tax (Administration)** | **GST (Law)** |
| • Annual tax returns and regular business activity statements<br>• Unnecessary ATO contact (eg chasing tax debts that have already been paid)<br>• Tax reporting not aligned to the business' natural reporting systems<br>• ATO forms – the number of forms, their design and the relevance of the data requested<br>• Responding to ATO information requests, correspondence<br>• ATO information and guidance 'pushed' to taxpayers who find the material irrelevant to their specific circumstances | • Risks and uncertainties of applying the GST-free going concern concession, and the GST-free export provisions<br>• Complexities in determining classifications of GST-free, taxable and input taxed supplies<br>• Compliance with the margin scheme rules for real property transactions.<br>• Requirement to lodge a monthly BAS to access the deferred GST Scheme for imports<br>• Inflexibility with Tax Invoice and Recipient Created Tax Invoice (RCTI) rules<br>• Need to assess and monitor the GST registration threshold<br>• Need to assess and monitor the Financial Acquisitions Threshold (FAT) |
| **Other** | **GST (Administration)** |
| • The delay which often occurs between the announcement of a change to the tax law, and the introduction of the relevant legislation to Parliament<br>• A tax penalty and interest regime generally regarded as excessive and unfair (particularly in terms of it being a problem when SMEs are struggling with unpaid tax debt and trying to get back on track). | • Delays in obtaining ABN/GST registration numbers<br>• Delayed refunds due to verification checks by ATO with third parties |

**Our submission comments below on the following discussion questions in the TDP:**

45. How effective is the current range of tax concessions (such as CGT and industry specific concessions) at supporting small business engagement with the tax system? To what extent do the benefits they provide outweigh the compliance, complexity and revenue costs they introduce?
46. What other mechanisms (such as a single lower tax rate, improved technology deployment or other non-tax mechanisms) could assist small businesses to engage with the tax system while decreasing compliance and complexity costs?

## 6.6 What is a small business? A whole of government approach

CA ANZ has long advocated a simpler definition of 'small business' which should be applied consistently throughout tax legislation.

In 2006, we sponsored research on this topic by the University of New South Wales[60]. Although some improvements to the tax law dealing with the definition of small business have been made since the report was published, some of the remaining proposals put forward by the authors deserve consideration, including:

- The creation of a 'whole of government' approach to the definition of small business which would see the enactment of a separate definitional Act (eg named the Small Business (Definition) Act 2014) relevant to tax and other areas of government administration, such as eligibility for small business grants, collection of statistics etc.
- A review of current rules for identifying a small business 'group' for determining eligibility for concessions.
- The automatic indexation of small business eligibility thresholds (eg turnover and asset amounts) so that access to the concessions is maintained for small businesses established in the future.

The current $2 million cap on the aggregated turnover test for defining a small business is seen as too low by many CAs in public practice.

## 6.7 Does our tax system overly reward businesses that remain small?

An alternative (and perhaps unpopular) way of looking at small business tax policy is to consider what role the tax system should play in helping businesses grow, as distinct from focusing on tax breaks for those businesses that start small and stay that way.

This issue is alluded to in the TDP ("…tax incentives for growing businesses may not be relevant to small businesses that have no intention to grow"[61]). As a community, we often hear calls for supporting small businesses because it is from this sector "that the next 'Apple' will come from". But not all small businesses aspire to be the next 'Apple' or to grow. For some a small business is a way of life.

The OECD recommends that countries must first decide what problems are faced by small businesses and then, if they consider the problems are sufficient to warrant government action, they should consider the relative merits of preserving a neutral tax system and using direct expenditures to pursue small business policy objectives, since non-tax measures will often be better targeted than tax measures.

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60 Available from our website. http://www.charteredaccountants.com.au/Industry-Topics/Tax/Publications-and-tools-NEW/Publications-and-tools/Definition-of-Small-Business.aspx

61 TDP at page 106.

Judith Freeman also makes the point[62]:

> "Even if it makes sense to target new firms or growth or entrepreneurship in some circumstances, targeting size per se is likely to lack rationale and therefore effectiveness. Second, it is easy to slip from thinking about entrepreneurship or growth to suggesting proposals about reliefs or incentives for all small businesses. This is a process that can create distortion in the tax system without necessarily being of clear economic benefit. Johansson et al produce evidence to suggest that favourable tax treatment of investment in small firms may be ineffective in raising overall investment."

This implies that factors other than "smallness" should have a greater influence on our policy thinking, and suggests that policymakers should be more focused on measures which encourage innovation, investment and the hiring of employees.

## 6.8 The existing small business capital gains tax concessions

Despite the fact that Division 152 was designed to provide CGT relief for small businesses, the relevant law clearly fails the tax criteria of "simplicity". If nothing else, a re-write project is required, particularly to the eligibility rules and associated entity tests.

In terms of policy, we readily acknowledge that the existing concessions are generous and it is difficult to prove (or disprove) categorically that they have had a favourable impact on risk-taking, entrepreneurial behaviour. Anecdotal evidence from our members is that the concessions continue to provide a valuable means by which small business operators can access funds for expansion or retirement (the originally stated policy intent of these provisions).

But as part of the trade-offs for a lower company tax rate, we agree with the Henry Tax Review that the existing concessions should be reviewed, rationalised and simplified[63].

As part of this review, retirement funding is perhaps the key area where we would urge the government to maintain a favourable CGT framework. Members tell us that small business operators continue to under-fund their superannuation needs because of cash flow problems during the years in which their businesses are operational. If any changes were to be made to the small business retirement exemption in Subdivision 152-D ITAA 1997, it would seem to us that, in all fairness, another mechanism would need to be found in the superannuation contribution deduction rules to allow such taxpayers a one-off, large, deductible contribution.

It is difficult to see how small business operators could be required to contribute to superannuation during the years in which business is carried on. In many cases, the money is simply not available.

Similarly, in the scenario where the small business is expanding, any change to the existing small business CGT concessions would need to coincide with a review of the general CGT rollovers which facilitate economically desirable restructuring and acquisitions.

As we have previously noted in our submission to the Board of Taxation's Review of impediments facing small business, a barrier to small business re-structuring in Australia is the lack of disincorporation rollover relief to transfer assets back into the owner's hands (eg once a business ceases and asset protection is no longer a factor, or to facilitate succession planning).

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[62] Freeman, op cit. Page 168.
[63] Henry Tax Review (2009). Recommendation 17(b).

For all these and other reasons, it was therefore pleasing to see the announcement in the 2015-16 Federal Budget that the Government will release a consultation paper on potential changes to the Corporations Act "to reduce any unnecessarily burdensome or restrictive regulatory requirements for small businesses".

> We remain supportive of the policy basis for the existing small business CGT concessions, but recommend that the relevant income tax legislation be reviewed and simplified.
>
> We note the 2015-16 Federal Budget announcement on consultations for changes to the Corporations Act which would further assist small business and look forward to contributing to the consultative process.

## 6.9 Division 7A ITAA 1936 – disguised profit distributions from private companies

The different outcomes where income is received by a company and an individual give rise to tax planning opportunities.

The sole reason for the existence of Division 7A is to limit the ability of private company shareholders to exploit these tax arbitrage opportunities. Division 7A is notorious, both for its complexity and the tax problems surrounding the use of tandem structures involving a private company and a discretionary trust (ie the unpaid present entitlement issue).

These provisions are in urgent need of review and (hopefully) simplification.

There have been many reviews of Division 7A, the latest of which has been the Board of Taxation's "Post Implementation Review of Division 7A of Part III of the *Income Tax Assessment Act 1936*". CA ANZ contributed to the Board of Taxation's review.

The complexity of the issues associated with Division 7A is reflected in the protracted process in releasing this latest report. On 18 May 2012, the then Assistant Treasurer announced that the Board would undertake a post-implementation review of Division 7A of Part III of the *Income Tax Assessment Act 1936*, which was to be completed by 30 June 2013. On 8 November 2013 the Assistant Treasurer announced an extension to these terms of reference and extended its reporting date to 31 October 2014. It was only on 4 June 2015 that the Board of Taxation's report into Division 7A was finally released.

> The Board's report contains a number of recommendations which have merit. We understand that the Board's findings will now be considered in the lead up to the Green Paper.
>
> CA ANZ is happy to work with Treasury officials on the Board's recommendations.

## 6.10 Industry specific concessions and small business – the rural sector

We have received representations from CAs with clients in the rural sector that it would be timely to benchmark Australia's rural tax framework with other countries, such as New Zealand and Canada. They acknowledge however the welcome enhancements to the FMD scheme which were enacted in May 2014 and confirm that primary producer provisions such as averaging, FMD deposits and forced sale of stock provisions work well.

Areas for potential review include:

- The expected impact of environmental factors on this sector such as extended period of drought and other natural disasters (recognised in the 2015-16 Federal Budget announcement of a 100% write-off for water facilities and fodder storage)
- The increasing impact of technological change, requiring a review of current safe harbour depreciation rates for depreciating assets used in the rural sector
- The difficulties associated with hiring labour in regional and remote locations (eg the 2015-16 Federal Budget decision to treat all individuals with a working holiday visa as non-resident, the employee – contractor distinction, the limited nature of living away from home concessions)

Also, the single touch payroll proposal has struck a sensitive nerve in industries, such as primary production, where cash flows are seasonal and sometimes unreliable, and the business owners are increasingly aging and are not all savvy with information technology. CA ANZ will be participating in further discussions with the ATO on this measure.

## 6.11 Small business and tax technology

CA ANZ supports greater use of business technology for many reasons, including the potential to significantly reduce compliance costs.

SBR is seen by the ATO and other government agencies at both Federal and State level as a key driver for lowering future compliance costs, particularly for small business. We agree that SBR has great potential. For that reason, many implementation issues associated with the expansion of SBR deserve greater focus from government, both Federal and State.

The Green Paper should address drivers of tax technology change, such as:

- An agreed, staged implementation timeframe determined in association with leading small business associations, accounting and book-keeping bodies which will set a target date for *full* SBR implementation as part of an overall 'e-government' strategy. The newly established Digital Transformation Office should take the lead here.
- Administration incentives for users of SBR enabled software, such as modest ATO lodgement extensions, fast service guarantees etc. Extended tax debt payment plans could be made conditional on the business having SBR enabled software so that the ATO can better monitor the business' ability to repay the debt.
- Additional government support on promoting SBR and small business owner education, in keeping with Recommendation 127 of the Henry Review.

# 7: Not-for-profit sector

**Our submission comments below on the following discussion questions in the TDP:**

47. Are the current tax arrangements for the NFP sector appropriate? Why or why not?
48. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?
49. What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?
50. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

## 7.1 The NFP sector – Introductory comments

There are a large number of NFP organisations in Australia and the quantum of the tax concessions associated with them are significant.

A number of reports touching upon the taxation treatment of this sector and the questions posed in the DTP have been published, including, but not limited to:

- the 2001 Report of the Inquiry into the Definition of Charity and Related Organisations
- Productivity Commission Report in 2010 - Contribution of the Not-for-Profit Sector
- The Henry Tax Review, and
- The final report of the Not for profit sector tax concession working group (May 2013)

Unfortunately, it is also a topic area where tax consultations have commenced, stalled and then been abandoned.

A consultations process announced in the 2011-12 Federal Budget to better target tax concessions for the NFP sector was later jettisoned by the current Government when it announced on 14 December 2013 its position on announced but not yet enacted measures. At that time, the Government said it would "explore simpler alternatives to address the risks to revenue".

Later, on 13 May 2014, the government announced that it had concluded that alternatives to the better targeting of not-for-profit tax concessions measure were not required at this time.

## 7.2 Measuring what we don't know

As noted in the TDP, quantifying the revenue forgone from NFP concessions is difficult, given that most do not lodge tax returns.

Deductible gift recipient status is relatively easy to obtain for well-advised organisations. Individuals or groups have also been motivated to set up foundations which champion specific causes.

Larger charities have expanded into activities which arguably compete in some respects with private sector businesses (eg the sale of subsidised food, second-hand clothing, industrial rags, re-cycled products, vocational training). Governments have been supportive, allocating some agencies with community assistance tasks which would otherwise have been performed by the public or private sector.

Clubs and associations founded and run on the mutuality principle largely operate under the ATO radar as 'low risk' entities, although they do tend to attract attention as the scale of their activities grow into areas such as club facilities offering food, drink and entertainment. Formulaic approaches developed by the ATO in association with the club industry apply to the apportionment of member and non-member income.

There have been some salary packaging tax planning opportunities in certain parts of the NFP sector which are not available generally to all employees, and the recent 2015 Federal Budget responded to this with changes to aspects of the FBT regime. As noted in the TDP, these opportunities are magnified where the relevant employee (eg a doctor) works for multiple employers in the sector.

On the donations side, it has proved difficult to implement an adequate data matching regime which accurately validates the donation claimed as a deduction and measures the aggregate deductions claimed and amounts received.

In an administrative sense, the future of the ACNC has been under a cloud even as it has diligently gone about its regulatory work, which includes improved reporting and monitoring.

We support the work of the ACNC and its on-going efforts to improve the data collected from the charity sector. Together with the ATO's own data gathering efforts and a suitably tailored investigation strategy from both organisations, Treasury should seek to get a better policy picture on this sector in terms of revenue risk.

Continuing efforts should be made to weed-out non-functioning charities from the sector.

The ATO should develop more transparent rules around the way it applies the mutuality principle and the 'line' beyond which the principle ceases to apply.

As part of our suggested abolition of FBT, consideration should be given to targeted payments to encourage employees to work for NFP hospitals and ambulance services so that the community's support is transparent, not disguised through salary packaging opportunities unique to this sector[64]. These targeted payments should be means-tested.

We agree with the Henry Tax Review that the gift deductibility threshold should be raised to $25[65].

The ATO, Digital Transformation Office and the charitable sector should set as one of their 'early win' targets the creation of an online tool for making charitable donations and receiving acknowledgement of the gift. This data would feed into the ATO systems for pre-filling on tax returns and could be matched by the ACNC against annual reports lodged by charities. Alternatively, consideration could be given to overseas models which operate in a self-assessment tax system (such as Gift Aid in the United Kingdom[66]).

[64] Refer Henry Tax Review 2009, Recommendation 9. The final report of the Not for profit sector tax concession working group attempted to quantify the cost of FBT-related salary packaging.
[65] Henry Tax Review 2009, Recommendation 13.
[66] Refer Gov.UK website: Source: https://www.gov.uk/donating-to-charity/gift-aid

# 8: GST and State taxes

**Our submission comments below on the following discussion question in the TDP:**

51. To what extent are the tax settings (that is, the rate, base and administration) for the GST appropriate? What changes, if any, could be made to these settings to make a better tax system to deliver taxes that are lower, simpler, and fairer?

CA ANZ is currently working on a research paper which will focus exclusively on the GST aspects of tax reform. Once completed, this research will be made available to Treasury as part of a further contribution to the tax reform process.

This part of our submission reflects some of the current thinking contained in our research.

## 8.1 General comments

Since the introduction in 2000, there has been continued public debate surrounding the merits of increasing the rate of the GST and / or expanding the base of goods and services it is applied to.

In terms of enhancing our Australia's prosperity, the long-held position of CA ANZ has been that increasing our nation's reliance on more efficient indirect taxes (such as the GST) at the expense of less efficient direct taxes (such as personal income taxes) would provide a growth dividend for the economy and contribute to a more sustainable tax base for the future.

Equally, however, an increased GST take would raise prices to consumers, with an effect on the living standards of the less well off – a key fairness issue.

Accordingly, any 'tax mix switch' in favour of the GST would need to be accompanied by appropriate compensation measures. Concerns over fairness are not something which can be addressed by the tax system alone however: it is important to consider the progressivity (or lack thereof) of the tax and transfer system as a whole rather than focusing on its individual components.

We also believe that fairness isn't the only key criterion in this context: it is important to consider the efficiency gains of indirect taxes compared to direct taxes.

## 8.2 Expanding the GST

The GST 'levers' are relatively straightforward. Expanding the GST could be achieved via an:

- increase in the GST rate, and / or
- expansion of the tax base to incorporate additional goods and services currently not subject to the tax.

### 8.2.1 Lifting the GST rate

Simply lifting the rate of the GST above the current level of 10% would be the easiest Approach to increasing GST revenue.

However, increasing the rate of the GST would be regressive if done in isolation. The TDP rightly notes that low income households consume a higher proportion of their income than higher income households. This means that raising taxes on consumption will increase their relative tax burdens (total tax paid as a proportion of income) compared with higher income households.

Low income households would also be more heavily affected as they may not have the means to make up the additional cost and would have to consume less, whereas high income households could make up the difference though lower saving rates.

### 8.2.2 Expanding the GST base

Under existing arrangements there are a number of goods and services which are outside the GST net:

- Some goods and services are 'GST-free' – meaning that the GST is not collected on sales, but that businesses are able to claim GST credits. These include:
    - fresh food;
    - health services;
    - education services;
    - water and sewage;
    - child care; and
    - online overseas transactions involving goods valued at less than $1,000.

- Other items which are 'input taxed' – meaning that no GST is collected on sales but that input credits cannot be claimed. This effectively embeds a GST component in the price of these goods, though that component is less than the full rate of 10%. Financial services and residential rents are both included in this category, although financial services are particularly problematic given the difficulty of determining the value added.

As a result of these features of the GST law, Australia's GST only applies to less than half of all consumer spending – a share which has been falling over time. That decline is set to continue, as spending on those goods excluded from the GST is growing faster than spending on those goods included in the GST base[67].

It is also worth noting that expanding the base not only improves the sustainability of GST revenues, but also offers administrative and compliance benefits – particularly in the case of items such as fresh food.

However, many of the items listed above are excluded from the GST on equity grounds, as they are considered to be 'necessities'. While this argument is quite easy to overstate, it is broadly true that the expansion of the GST base may have different impacts on fairness than would a simple lift in the GST rate, with those impacts varying depending on which items are added to the taxable basket of goods and services.

Using the introduction of fresh food into the GST as an example, this could be considered to be regressive in isolation. Using data sourced from the Australian Bureau of Statistics, fresh food makes up a higher proportion of total expenditure for lower income earners than high income earners. Specifically, fresh food makes up 10.8% of expenditure for the average household in the lowest quintile, but only 6.5% for the average household in the highest quintile. Therefore, these households would be disproportionately affected by the increased tax burden.

[67] 2015 Intergenerational Report, page 82.

## 8.3 The size of the prize

Bearing in mind that expanding the base has different effects depending on what is included, taxing fresh food would have the highest effect on revenue, while including child care would have the least.

Recent research conducted on behalf of CA ANZ estimates that including fresh food would raise an additional $24 billion over four years in gross GST revenue if the rate was maintained at 10%, while including child care would increase gross revenue by $3 billion over four years.

Overall, increasing the base to include all the items shown above as outside the GST net and increasing the rate to 15% is estimated by our recent research to raise an additional $265 billion over four years.

## 8.4 Compensation and economic effects

If the Government cannot adequately compensate low to middle income households for changes in GST, then community support for change is unlikely.

We are also conscious that large price shocks would need to be avoided for several valid economic reasons (ie unduly suppressing consumer demand, and the creation of ongoing pressure on inflation and wages by increasing inflation expectations in the community).

Even a phased introduction of GST changes can cause problems, as occurred recently in Japan.

There are four scenarios we would like to model with Treasury for the Green Paper:

- **Scenario 1 –** increasing the rate of the GST to 12.5% with no change to the GST base. [Low CPI impact – less compensation required]
- **Scenario 2 –** leaving the rate of the GST at 10% but expanding the base to include fresh food, health services, education services, financial services and child care.
- **Scenario 3 –** increasing the rate of the GST to 12.5% and expanding the base to include fresh food, health services, education services, financial services and child care.
- **Scenario 4 –** increasing the rate of the GST to 15% and expanding the base to include fresh food, health services, education services, financial services and child care. [Highest CPI impact – most compensation required]

Not only has Treasury modelled the compensatory adjustments for the introduction of GST, it also has more recent experience with the household compensation package accompanying the carbon tax.

Our current thinking is that a possible compensation package would be similar to that implemented with the original GST reform and the carbon price.

The proposed split would be 60% tax cuts and 40% increased transfers, reflecting the dual role of tax cuts as compensation and an overall reform objective. The increase in transfer payments would be mostly spent on increases in pension and benefits rates with some additional assistance provided to families through increases to family assistance payments.

Compensating those on fixed incomes is particularly difficult in the current environment of constrained government spending. The two approaches to model here are:

- providing an additional supplement and once-off upfront payment to cover the additional costs of the GST changes (the preferred method for the carbon tax package)
- a one-off increase to the base rate of pensions and benefits on the date of the introduction of the tax change

Ideally, the chosen GST compensation arrangement would be dovetailed with reforms to the broader transfer system along the lines recommended in the recent McClure Report[68] into the welfare system (ie a new transfer payment architecture built around five main payments).

The Government should use the Green Paper as an opportunity to convey more detailed modelling to the Australian community about the various scenarios for increasing the GST rate and \ or the GST base, together with possible compensation arrangements.

If State and Territory support is essential to any legislative change, then the position of those Governments should be sought and made public as soon as possible so that we can determine whether GST reform is indeed 'in the mix'.

In the absence of GST reform, the Green Paper should elaborate on the difficulties our nation will face in the future if we do not have recourse to increased tax collections from the GST.

**Our submission comments below on the following discussion question in the TDP:**

52. What are the relative priorities for state and local tax reform and why? In considering reform opportunities for particular state taxes, what are the broader considerations that need to be taken into account to balance equity, efficiency and transitional costs?

The priorities for state tax reform should be set by identifying with the states and territories the most inefficient state taxes, and agreeing to a disciplined, systematic program for abolishing those taxes and replacing them with more efficient and reliable (less volatile) taxes, such as consumption taxes and land taxes. Key considerations in this process, as alluded to in the question above, include comparing the relative efficiency, stability and equity of the various state taxes, and also recognising that regressive impacts are often better dealt with via compensatory measures / the transfer system, rather than by making exceptions and exemptions in the tax itself.

Importantly, we envisage that this process would also involve the same type of approach as that adopted in negotiating the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations in 1999, which incorporated a Schedule of state taxes and an agreed timetable for their abolition by each of the states and territories, in exchange for a share of revenues from the GST.

Among the top inefficient state taxes in our view are: conveyance duty, insurance duty, and motor vehicle registration duty. This view broadly aligns with conclusions reached and the recommendations made in the Henry report.

- Stamp duties, are widely recognised as economically inefficient taxes. They are inefficient because they raise the cost of consumer and business transactions. There is also considerable variation between States raising costs for businesses and consumers. The removal of these types of taxes should be a priority given the potential net benefits from reform.

[68] Review of Australia's Welfare System

- CA ANZ proposes that insurance duties in every State and Territory be abolished. Insurance duties are regressive and disproportionately impact lower income households. Abolition would improve equity by reducing insurance costs for lower income householders and risks of under-insurance. This measure is one of the only targeted means available to government to promote adequate insurance for lower income households. Abolition would also improve overall economic efficiency and simplify tax-related administration.

We commend the ACT for embarking on a well-planned, long-term phasing out of conveyance duty on real property transactions, in favour of a move towards more efficient and sustainable tax bases, such as greater reliance on land tax.

**Our submission comments below on the following discussion question in the TDP:**

53. Does each level of government have access to tax revenue bases to finance new spending decisions? If not, should arrangements change to achieve this? How should they change? How important is it that the national government levies taxes on mobile bases? Could some taxes be shared?

We tend to prefer the notion that the Federal government should levy taxes on more mobile tax bases, which is in line with the Henry review findings.

However, we also support the idea of exploring opportunities for certain good quality tax bases to be shared by state, territory and federal governments, but centrally administered by the federal government on behalf of the states and territories. This would enhance autonomy of the States, as well as improve revenue sustainability. As Henry illustrated, current State taxes are not well placed to fund services into the future, being too numerous, complex, narrow-based, unstable and costly to administer.

# 9: Indirect taxes

**Discussion questions:**

54. To what extent does Australia have the appropriate mix of taxes on specific goods and services? What changes, if any, could improve this mix?
55. To what extent are the tax settings (ie the rates and bases and the administration) for each of these indirect taxes appropriate? What changes, if any, could be made to these indirect tax settings to make a better tax system to deliver taxes that are lower, simpler, fairer?

Australia currently has a range of indirect taxes on specific goods and services. These include taxes on alcohol, tobacco, fuel and luxury cars.

## 9.1 Alcohol taxation

As identified in the TDP, the taxation of alcohol has two separate regimes – a tax for wine products, which is value-based, and an excise for other alcoholic beverages, which is volume-based with 16 different excise categories.

In our view, the taxation of alcoholic products is long overdue for reform, with the current rules being incoherent, complex, poorly targeted, and in need of rationalisation to remove anomalies and distortions, and achieve intended policy objectives.

Broadly, we support a reformed approach to the taxation of alcohol along the lines recommended in the Henry report, whereby alcohol is taxed under a common alcohol tax which better addresses social harm. This would involve a volumetric-based tax across all forms of alcohol. That is, alcohol taxes to reduce (or compensate for) spill over costs should target alcohol content.

The rate should be based on detailed information / evidence of the net social costs of alcohol consumption. Ideally, a single, uniform rate of tax across all alcoholic beverages should be adopted in the longer-term.

We recognise that such a change is likely to have detrimental impacts on certain parts of the sector, and as such, it should be subject to appropriate transitional and/or compensatory arrangements being put in place.

A corresponding simplification of the administration and compliance obligations in relation to alcohol taxation should also form part of the reforms in this area.

## 9.2 Fuel excise/duty

We acknowledge the rationale behind the government's proposal to re-introduce indexation in relation to fuel excise. However, if that is to occur, it should be as part of a broader commitment to index thresholds in our tax system.

Many parties in the community see the Fuel Tax Credit (FTC) as a subsidy to large miners and also a subsidising of carbon emissions.  We are not surprised that it is subject to such criticism because we believe the policy objectives behind it are confused, debatable and inconsistent. For example, it is hard to discern a coherent policy objective that enables the fuel used in a refrigerated van to be subject to FTC rates of 38.9 cents per litre (cpl) and 12.76 cpl for the fuel portions used in the refrigeration unit and in road travel respectively.

The overall FTC policy objective appears to be the removal of embedded taxes on business whilst maintaining a charge on road use. Given the budgetary constraints faced by government and the community concerns about the effect of fuels upon climate change the policy objectives behind the FTC need to be articulated clearly and debated for relevance and priority. The current FTC regime needs to be reviewed to determine if it meets those objectives, whether the current rate differences are appropriate and whether any FTCs are available that are unwarranted on policy grounds.

## 9.3 Tobacco excise/duty

We support retention of the tobacco excise/duty regime and believe that rates should be increased (to reflect increasing social costs) and should be indexed (to wages rather than the CPI) as recommended by the Henry Review. We also support removal of duty-free allowances for tobacco products.

## 9.4 Luxury cars

We support the Henry report recommendation to work towards abolition of the Luxury Car Tax (LCT). The LCT is no longer fulfilling its original policy objectives, and has numerous unintended outcomes, such as discouraging the purchase of more fuel efficient vehicles, as well as discriminating between luxury cars and all other luxury goods.

# 10: Complexity and administration

**Our submission comments below on the following discussion question in the TDP:**

56. What parts of Australia's tax system, and which groups of taxpayers, are most affected by complexity? What are the main causes of complexity?

## 10.1 Complexity

The issue of complexity arises in numerous chapters of the TDP and is commented on in other parts of this submission.

CA ANZ again observes that the Henry Tax Review has traversed much of the ground covered in the TDP on this topic. The Henry Tax Review concluded our tax laws are too complex and we are reaching a stage where areas of the tax law are close to being 'un-administrable'.

In addition, we have since witnessed the recognition that Governments cannot clear a backlog of technical corrections (or, we would argue, even more substantive tax announcements).

Thus the ATO is being handed greater discretion for statutory interpretation as a possible solution (this measure is known within tax circles as the Commissioner's Statutory Remedial Power). At the same time, however, Governments continue to add to the tax announcement backlog with new tax proposals.

We agree with the comments expressed in the Henry Tax Review. A good understanding of the tax law is the bedrock of a self-assessment tax regime and yet the growing complexity of Australia's tax laws are fracturing that bedrock.

Throughout this submission, we have tended to favour tax reform options that focus on reducing complexity, sometimes at the expense of fairness. We acknowledge this bias does run the risk of proposed reform options being more difficult to attract support.

Accordingly, and somewhat contrary to suggestions in this chapter of the TDP, we would propose the weighting is reversed when it came to the transitional aspects of tax reforms. That is, notwithstanding concessional grandfathering will increase complexity, we tend to favour fairness over complexity when it comes to the transitional rules for tax reform options.

However, this does not mean these transitional rules must ensure pre-existing tax treatments are unaffected in perpetuity. Nor does it mean that existing grandfathering concessions for earlier tax reforms are 'off limits' in any Green Paper options.

In designing transitional rules necessary to implement Green Paper measures, the Government should be mindful of the unsettling impact of change and craft suitably generous transitional measures. These measures should favour fairness over complexity.

## 10.2 Ideas on reducing complexity

We consider the following ideas have the potential for sizable, positive impacts in reducing tax complexity:

- Embrace the Henry Tax Review recommendation of concentrating revenue raising into fewer taxes.
  - Alternatively, pursue compliance cost savings through the use of the same tax base in multiple Federated taxes.
- Australia should move towards a single Federated tax administration system whereby:
  - the 'front end', client facing systems are centralised into one system, or
  - we establish one Federated tax collection agency.
- Establish a centralised, whole of government approach to debt collection, regardless of whether the debt relates to income tax, student loans, ASIC fines etc.
- Additional resources are allocated to the ATO (and other relevant Federal and State agencies) to embrace tax and transfer payment simplification.
- Target tax reforms for particular taxpayer segments with the goal being a greater use of financial account or bank account information in their tax bases.
- Focussing on 'circuit breakers' to the resistance being encountered towards SBR and other electronic interfaces (ie not only the transitional change costs but also the ongoing costs associated with regular tax changes causing regular software upgrade costs).

The Green Paper should provide a stocktake of the Henry Review recommendations focussed on complexity reduction, supplemented by ideas arising from submissions to the TDP, and propose a number of practical tax compliance cost saving measures.

**Our submission comments below on the following discussion question in the TDP:**

57. Would there be benefit in developing an Australian metric for tax complexity? What factors should be included? How should they be combined into a metric?

## 10.3 Tax complexity metric

CA ANZ considers there is limited benefit in developing an Australian metric for tax complexity.

There are a number of Henry Review recommendations that remain work in progress, have hit road blocks or are yet to be actioned. These should be attended to in priority to this proposal.

Those recommendations include:

- A single tax and transfer client account.
- A comprehensive framework for pre-filled personal tax returns (or our preferred model, an optional 'no personal tax return required' outcome).
- 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.
- Third party data collection (but with greater alignment with existing information concepts and systems of third parties and facilitated through electronic interaction with information held in the 'natural systems' of those entities).
- SBR enabled software solutions to reduce the compliance costs associated with business interactions with government.
- Start-up assistance for small businesses to be 'business ready' from the outset. This could be achieved through education and financial assistance, which may include assistance on SBR.
- Common information standards, leveraging from the standards and governance put in place by the SBR Program.
- The systematic collection of data by Federal and State Governments on aspects of existing taxes and transfers, including compliance cost data.

We also consider that if the United Kingdom is already developing a 'Tax Complexity Index[69]', there seems little point in duplicating the research and development effort.

Finally, we observe New Zealand is often highly regarded when it comes to tax simplification and note that that country has been able to manage this without the need for some type of metric.

CA ANZ does not support the development of an Australian metric for tax complexity as an immediate priority.

**Our submission comments below on the following discussion question in the TDP:**

58. What system-wide approaches could have the greatest impact on reducing complexity in the tax system? Why have previous attempts to address complexity in the Australian tax system not succeeded? How might it be done in a way that is more successful?

## 10.4 Failed attempts at addressing complexity

As for the first question posed, see previous comments.

In terms of why previous attempts to address complexity have failed, we would suggest the following contributing factors:

- An overly strong focus on predicting likely avoidance responses to new measures during the design phase, rather than reliance on ATO discretion and application of the General Anti-avoidance Provision (Part IVA ITAA 1936). We readily acknowledge that the self-assessment system has itself contributed to this thinking.
- An inconsistent drafting approach between principle-based styles and 'black letter law'.
- Attempts to cater for specific circumstance, even if only a comparatively small number of taxpayers are affected or the particular transaction is not common.

[69] A project of the UK Office of Tax Simplification. Refer https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/285944/OTS_Developing_a_Tax_Complexity_Index_for_the_UK.pdf

- A reluctance by Government Ministers (or senior bureaucrats) to allow Treasury and ATO officials to engage in collaborative law design workshops with external stakeholders (an open, 'sandpit' approach to law design).
- The failure to complete the rewrite of the ITAA 1936.
- An ATO unsure of the limits (or potential) of the Commissioner's general powers of administration and Part IVA, which – on occasions – may have contributed to too many ATO requests for legislative intervention (and a Treasury sometimes too quick to accede to such requests without considering alternate approaches to legislative change).

**Our submission does not comment on the following discussion questions in the TDP:**

59. In what ways can reforms of tax administration best assist in reducing the impact of complexity on taxpayers? Are there examples from other countries of tax administration reform to reduce the impact of complexity that Australia should adopt?

60. What processes or systems currently being used by businesses and individuals could the ATO better utilise to lower the compliance costs of the tax system?
61. Could administrative responses — such as embracing technology, harnessing data and taking the whole-of-government approach to administration — help address the issue of tax system complexity?
62. Would there be benefits in integrating the administration of taxes across the Federation? If so, what would be required to realise these benefits?

Parts of our submission already touch upon the issues raised in these questions.

# 11: Tax system governance

**Our submission comments below on the following discussion question in the TDP:**

63. What changes could be made to provide greater certainty, transparency and accountability to tax policy development in Australia?
64. Are current tax review arrangements appropriate? How could they be improved?
65. Could the arrangements for developing tax policy in Australia be improved? If so, how?
66. Would the benefits of releasing more tax data and detail around costings outweigh the costs?

## 11.1 Australia's current tax policy governance arrangements

Our concerns over Australia's tax system governance culminated in the production of a CA ANZ briefing paper to Treasury and the (then) incoming Government in September 2013, titled '*Solving the problem of the tax announcement backlog'*.

Detailed below is an extract from the briefing paper's concluding remarks:-

> *There is growing tension amongst the taxpaying community around the pace of change to the tax system.*
>
> *On the one hand, stakeholders are demanding tax changes and technical corrections be announced and implemented much faster to ensure a level playing field, address revenue and integrity concerns or to clarify existing legislation. However, the regular stream of tax announcements is producing unforeseen interaction issues, constant change management costs and is weakening the bedrock of the self- assessment system. Thus, paradoxically, stakeholders are equally vocal in demanding a moratorium on new tax announcements. Indeed, stakeholders may cherry pick both sides of the debate depending on how much they have at stake on a particular tax change.*
>
> ….
>
> *In any event, [we believe] the government cannot continue to make 'add on' tax changes to complex tax law and expect the self-assessment regime to cope. In our opinion, even if we have the 'will' we are losing the 'way' to successfully implement moderate to large tax changes.*
>
> *At a very minimum, tax system stakeholders must be confident that we are adopting the very best project management practices in the development and design of our tax laws. Notwithstanding past reviews in this area, best practice is not consistently being demonstrated at present.*
>
> *There must be greater rigour and transparency around tax change decisions, resourcing, timeframes and reporting against key performance indicators. The backlog in the tax announcement pipeline must diminish, permanently. There also needs to be greater leadership, ownership and accountability demonstrated towards tax policy and tax law design processes. Treasury ministers and Treasury need to take greater responsibility to drive improvements in the process. Unrealistic private sector expectations must be better managed and self-serving behaviour under the guise of collaborative, open consultation needs to be challenged.*

*We all must ensure tax policy and tax law design is meeting tax system stakeholder expectations, is subject to continuous improvement and that the care and maintenance of the tax laws is paramount."*

Almost two years on, CA ANZ believes Australia's governance arrangements around tax policy, tax law design and consultation still has plenty of room for improvement.

In this regard, we point to the following recent experiences:-

- The Government still struggles to deal with the tax announcement backlog.
- The managed investment trusts, tax consolidation and earn-out exposure draft legislation consultation processes have re-highlighted the tax policy and tax law design difficulties in dealing with the backlog of tax announcements.
- Whilst there are examples of greater strategic thinking being applied to the care and maintenance of the tax laws, it is still the case that tax policy, tax law design and tax administration consultation has lurched from 'feast to famine', with questions still being asked on possible process improvements.
- A 'classified' confidential, rather than transparent, consultation process still predominates tax policy decisions until the Government makes a formal announcement. In some cases the ATO also uses a 'classified' process.
- Government tax announcements still range from perceived 'off the cuff' decision making through to protracted negotiations.

## 11.2 Possible changes to tax policy governance arrangements and tax review bodies

The proposed longer term action points from our September 2013 briefing paper are still worthy of consideration. In summary, these were as follows:

- A generic best practice project management model for moderate to large tax measures and another model for the rest.
- Consideration be given to adopting a semi-annual tax amendment bill(s) legislative process (possibly moving towards an annual basis).
- The Government commits to release a tax announcement stock-take on an annual basis.
- Treasury Ministers take ownership of the tax announcement stock-take and the reporting thereon.
- Tax policy and tax law design resourcing and engagement is revisited by the Government and Treasury.
- Key Performance Indicators for 'consultation announcement to tax announcement' and 'tax announcement to tax bill' are agreed and measured.
- Consultation and legislative process standards are revised by Treasury.

In addition, we also note there are a number of Henry Review recommendations that remain work in progress or are yet to be actioned, including:

- Increased transparency in dealing with community ideas about the tax system (ie further developing Treasury's Tax Issues Entry System and integrating this with the ATO's consultation processes).
- Commitment to principles-based tax law design as well as:
    - releasing more information into the public domain on the purpose or object of major pieces of tax legislation,
    - improving the quality of tax announcement media releases, Treasury discussion papers and Explanatory Memorandum,

- robust regulatory impact statements on tax changes covering taxpayer outcomes and system impacts.
- A greater role, empowerment and resources for the Board of Taxation.
- Producing a tax and transfer analysis statement every five years on the performance of the system including efficiency and distributional impacts.
- Improved reporting of tax expenditures and greater symmetrical treatment of tax expenditures and spending programs across the Federation.
- Greater support for independent tax and transfer policy research.

Finally, the TDP's analysis of tax review bodies and the recent controversy surrounding corporate tax data, begs the question(s) as to whether:

- The Parliamentary Budget Office and Treasury have overlapping functions when it comes to revenue costings that could be streamlined.
- The Senate and House of Representatives committees enquiring into tax matters could be consolidated.
- Governments should arrange for more insightful Federated tax data to be published on revenue collections and tax expenditures to better inform public debate.
- The future role of the Tax Studies Institute as an independent policy research body is in need of a rethink.
- The Board of Taxation could be given a mandate to perform reviews covering Federated tax systems.

CA ANZ submits that given all of the above, the Green Paper should contain a proposed model for tax policy and tax law design processes (including consultation and reviews) as well as future tax announcements and tax legislation procedures.

- Governments of all persuasions must embrace substantive structural changes to tax policy and tax law design processes (including consultation) to achieve a more sustainable self-assessment tax system.
- Australia should be moving to a system of announcing tax changes semi-annually and should also consider moving to a semi-annual cycle for the introduction of tax bills. The objective of these approaches is to reduce the constant stream of tax announcements and improve the project management processes in implementing tax announcements.
- The Green Paper should contain a proposed model for tax policy and tax law design processes (including consultation and reviews) as well as future tax announcements and tax legislation procedures.
- Sustainable, best practice project management processes for tax policy and tax law design (including key performance indicators and reporting protocols) should be included in the proposed model including the future direction of independent tax and transfer policy research.

# Table of terms

A table of terms used in this submission is provided below:

| | |
|---|---|
| ABN | Australian Business Number |
| ACNC | Australian Charities and Not-for-profits Commission |
| ATO | Australian Taxation office |
| BEPS | Base erosion and profit shifting |
| BTWG | Business Tax Working Group |
| CA ANZ | Chartered Accountants Australia and New Zealand |
| COT | Continuity of business test |
| ELS | Electronic lodgment service |
| FBT | Fringe Benefits Tax |
| FMD | Farm Management Deposits Scheme |
| Henry Tax Review | Australia's Future Tax System Review (Final Report, May 2010) |
| IGR | Intergenerational Report |
| ITAA 1936 | Income Tax Assessment Act 1936 |
| ITAA 1997 | Income Tax Assessment Act 1997 |
| LTC | Look through company (New Zealand has such a regime) |
| Mirrlees Review | Mirrlees Review of the United Kingdom tax system (2011) |
| Murray Inquiry | Financial System Inquiry (Final Report, December 2014) |
| PAYG | Pay as you go |
| RBT | Review of Business Taxation, chaired by Mr John Ralph AO (Final Report, July 1999) |
| SBR | Standard business reporting |
| SBT | Same business test |
| SME | Small and medium enterprises |
| SMSF | Self-Managed superannuation fund |
| TDP | Re:think Tax Discussion Paper (March 2015) |