



## **Commonwealth Government – Tax Discussion Paper**

*Commercial Economics Consulting*

### **About Us**

Commercial Economics Consulting (ComEcCon) provides economic advisory services with a strong commercial focus to the energy sector and long life infrastructure businesses such as water services, port and rail businesses. These services include microeconomic analysis, business case development and project review, expert witness, modeling, and advice on regulatory and competition issues.

### **Structure of submission**

ComEcCon's submission to the Commonwealth Government's Tax Discussion Paper ("Taxation Paper") is focused on corporate taxation arrangements. Specifically:

- Overall comment
- The lack of an objective function within the current taxation law
- A proposal to simplify corporate taxation, and
- A proposal to improve enforcement activities.

### **Overall response**

Taxation has the potential to distort economic agent decision-making. An effective taxation regime should be seen to:

- minimise distortions to 'rational' decision making by economic agents
- maximise revenue in-take from the use of the least distortionary taxation tools,

where there is broad agreement on at least the quantum of revenue required to 'finance' the provision of services by government(s).

Strategically, the Taxation Paper does not address nor provide comment on what constitutes the quantum of revenue required to finance those services that governments provide. Clearly, there are significant political consequences for any political party that transparently articulates what government's should supply.

Despite the political limitations, we consider that there is a need to debate what services government's should supply, and the extent to which a user pays principle should apply. That is whether in supplying these services there is a requirement that:

- a 100% user pays principle applies; or
- a partial user pays principle applies requiring the need for some subsidisation from general taxation revenues, and
- the supply of specific government services are totally financed via taxation revenues.

Until we at least progress this debate then any discussion on the effectiveness of the current taxation regime, and alternates, becomes circular, as there is no reference point that we are solving for. A lack of a reference point leaves society without the means of

assessing alternatives to see which option provides the most benefit for the least cost.

On this basis we would commend that the current taxation review give consideration to what services need to be provided by government, and how best they should be financed. This is a crucial starting point for any meaningful debate on Australia's taxation framework.

### ***Lack of objective function***

We advise economic participants in the energy, utility and infrastructure industries. These industries are noted for their:

- long lived assets
- natural monopoly characteristics, and
- often strong legal and regulatory regimes to ensure that owners of such assets behave in a fair, reasonable and efficient manner.

Generally, for these reasons businesses that operate these assets are often subject to a form of behavioural, licence and economic regulation. This regulation is commonly enshrined in law, such as the Competition and Consumer Act (CCA).

Notably, within such legislation there is an objective function for the operation of the statute. For example, the National Electricity Law (NEL) contains the National Electricity Objective (NEO), which is:

"promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to -

- (a) price, quality, safety, reliability and security of supply of

- electricity; and  
(b) the reliability, safety and security of the national electricity system."

Or the objective for the general access regime in Part IIIA of the Competition and Consumer Act 2010, which is:

"...to promote the economically efficient operation of, use of and investment in infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets."

As practicing economists we consider that the taxation regime could be improved by the addition of an objective function to:

- guide policy makers in assessing which taxation tools to utilise, i.e a requirement or preference to adopt taxation tools that minimise distortions to rational economic decision making
- guide economic participants in how they organise their individual affairs and business models in response to taxation, and
- guide the Australian Courts when hearing a dispute associated with the interpretation of taxation requirements.

The inclusion of an objective function that requires the government to consider taxation in the context of minimising distortion would facilitate an environment where the choice of taxation approach becomes balanced with the notion of least impact on individual and corporate behaviour. We consider that this would facilitate more careful analysis of the:

- expected revenue to be collected by a tax, and

- the direct costs from taxation collection but also the opportunity cost of the tax.

From our perspective, it is clear that the inclusive of an objective function to guide taxation arrangements introduces a degree of moral judgement. Arguably, based on recent trends in the management of taxation affairs where seemingly economically profitable individuals and corporates are utilising sophisticated interpretations of tax rules to minimise their taxation liabilities to well below their peers, society as a whole may in fact be better off, by providing moral guidance on what is considered to be 'appropriate' organisation of taxation affairs.

We consider that an objective function within taxation regimes for economic agent behaviour should include reference to an economic agent's management of tax liabilities being consistent with at least the principle of horizontal equity, which requires that peers as measured by income or turnover should have a comparable level of taxation liability by reference to the effective tax rate levied. The inclusion of such an objective function would prove invaluable to guiding individuals and corporates when organising their taxation affairs, particularly, when making those numerous value judgement when interpreting taxation rules.

Importantly, the inclusion of an objective function when levying tax would provide the ATO and Australian Courts when hearing taxation disputes with a guide on how to measure the 'intent' of individuals and corporates when they established their taxation affairs. Moreover, a properly structured objective function when levying tax would balance the seemingly insatiable desire of agents to minimise taxation liabilities with a counter weight that actively

promotes a notion of fairness to society in the administration of the system.

### ***Proposal to simplify company taxation***

We agree in the main with the Taxation Paper's identification of the current issues associated with company taxation, particularly, the critical point, that as the burden of company tax passes to other economic agents it is crucial that it is as least distortionary as possible. Evidence that the current company tax is not achieving this objective can be found by:

- the estimated level of compliance burden and cost, and
- significant complexity driven by administrative arrangements rather than economic drivers.

We consider that an alternative to the current company tax regime would be to:

- set company tax rates not on a measure of earnings after expenses before tax but as a (low) proportion of revenue, and
- set the tax rate by reference to the industry that the company operates in, i.e. financial services industry 3% company tax rate on revenue.

This option would:

- reduce complexity from:
  - removal of special exemptions and allowances used by policy makers to 'encourage' specific forms of investment



- removal of the need for interpretation of accounting and taxation rules to measure earnings after expenses before tax
  - improve horizontal equity in taxation system
  - enhance vertical equity in taxation system, and
  - likely to improve efficacy of the company tax system by being a disincentive to corporates investing in complex taxation affairs.

Moreover, such a tax regime would improve transparency, and encourage a simple approach by company's in organising their taxation affairs. We consider that having these characteristics in a country's company tax regime is likely to be appealing to both domestic and foreign investment.

### ***Improving enforcement activities***

Given the current administrative complexities and substantial compliance burden associated with Australia's taxation system we consider that there is a need for enhanced enforcement. Rather than provide the ATO with further powers and resources we believe that there is merit in exploring the introduction of broader and more complete protections of whistleblowers.

In addition, to strengthen incentives for economic agents to comply with taxation regimes we would advocate that the government explore the 'whistleblower bounty' regime similar to the United States Securities and Exchange Commission's (SEC) Office of Whistleblower's power to be able to make monetary awards to whistleblowers from successful actions taken by the SEC.

A similar arrangement for taxation whistleblowers would provide powerful incentives for economic agents, particularly where the taxation regime includes an objective function that guides interpretations of tax impacts. Moreover, the effective implementation of such a proposal would provide substantial assistance to the ATO's enforcement activities.

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**Principals**

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