F. JOHN MORGAN

Barrister - at - Law

Room 215, Owen Dixon Chambers East, Level 2, 205 William Street, Melbourne VIC 3000

'Re:Think' Tax Reform Group
Federal Treasury
Canberra

Dear 'Re:Think' Group,

'Re:Think' Tax Reform Submissions - Various points [FJM's Own Comments]

1. I attach my comments in relation to various important discussion questions raised by the 'Re:Think' paper. These questions and my comments are set out below.

2. Please take note of the suggestions that would cut vast swathes of overly complex legislation from the statute books, would reduce compliance costs and would vastly improve the tax neutrality of commercial dealings (and with that promote economic growth). There might be some ideas there you could use.

3. I made these comments (via email exchange) to the Melbourne Chair of the Law Counsel's Tax Committee: Mr Adrian Varrasso for an impromptu appearance at the Board of Tax's consultation on these issues.

4. Having said that, the views I've expressed are my own and should not be attributed to any of the legal and tax professional bodies, of which I am a member.

5. I'm aware that these submissions are past the deadline but commend them to you for consideration, despite that.

Cheers,

F John Morgan
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Nationally Accredited Mediator

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On 14 Jun 2015, at 10:29 pm, Frederick John Morgan <f.john.morgan@vicbar.com.au> wrote:
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Begin forwarded message:

From: F John Morgan <f.john.morgan@vicbar.com.au>

Subject: Re: Board of Taxation meeting - LCA Tax Committee views [FJM Comments]

Date: 15 May 2015 8:01:43 pm AEST

To: Adrian Varrasso <adrian.varrasso@minterellison.com>

Good luck Adrian.

Re: Board of Taxation meeting - LCA Tax Committee views [FJM Comments]

1. I've set out a few thoughts below. They are probably a ridiculously costly wish list.

2. But there might be the odd idea there worth thinking about.

3. Note the ones that allow great swathes of the current complex law to be done away with.

4. Note also the ones that allow tax to go back to relying on things known to the general law, instead of relying on more and more defined comments that are more and more removed from the real world. This has been very costly.

Cheers,

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On 15 May 2015, at 9:13 am, Adrian Varrasso <adrian.varrasso@minterellison.com> wrote:
Dear members

I am attending the Board of Taxation on behalf of our Committee on Tuesday morning. We have been asked for our input on the following issues. So that I can represent our views, could members please provide me any comments they wish to feed into any of the below. Apologies for the timing, I have only just been advised of the below, so will need responses as soon as possible. The below should not be circulated outside our membership.

1. How could Australia's tax system be improved, in relation to:
(a) **Treatment of capital assets**
The entire CGT legislation should be scrapped and and taxed instead under the general provisions.

What constitutes a 'capital asset' could be left to the Courts (like in s8-1).

Costs in relation to those assets would not be immediately deductible but would be used to calculate the 'gain' at the taxing point (which would broadly be on disposal but hopefully could be defined in some more general way for the Courts to interpret - like 'loss or outgoing incurred to derive assessable income').

There might still need to be 'rollover' relief but it could well be streamlined in terms of common ownership.

Ask Cameron Rider about this idea (as one of his students asked him).

You will notice a theme in all that I suggest below of getting away from artificial tax concepts and allow tax to go back to acting on general concepts already known to the law (which is much simpler and less costly).

(b) Treatment of losses

Losses should be fully tradable by transfer registered with the ATO.

Integrity could be put into the system by giving the ATO (say) 6 months to audit the losses to be transferred.

Also the transferor might have to contribute a percentage of the consideration for losses found not to be deductible - perhaps to the transferee if they were disallowed at source.

All the complicated COT and SBT carry forward loss provisions (and the trust loss provisions) could be repealed.]

(c) Treatment of financing arrangements (debt, equity and retained earnings):

Payment of dividends should become deductible to the paying company (as with co-operatives currently).

Both dividends and interest on debt ought be frankable too.

At this point all the differences between debt and equity would have gone and the complicated rules around ‘debt interests’ and ‘equity interests’ could be abolished.

Likewise all the franking integrity measures could be abolished. There should be no restrictions in securities or the holders or the percentage at which these returns are franked. Dividend and franking streaming ought be allowable.

Franking credits ought be fully tradable too (perhaps with compensation measures as discussed above for loss transfers). Again this trading would have to be registered with the ATO too for tracking and auditing.

In this would dividend access shares for profits in country X could be used to pay shareholders resident in the same country (and likewise the holders of debt securities).

Franking credits should be given though for gains that would otherwise be assessable/taxable, so as to not claw back the relevant concession at shareholder level (eg. the claw back that occurs if it is a company that claims the small business CGT relief).

(d) **Distinction between revenue and capital**

I'd have this distinction fall back to the Courts and general principles.

There will still be a need for the distinction between income and capital in the system I advocate, not only because costs would not be deductible (but added to calculate gain) at the time of reaching the taxing point - which would mainly be disposal.

Losses on capital assets would be deductible just like revenue losses and able to be carried forward indefinitely as currently.

But there's another key difference that I'd advocate in the distinction between revenue and capital gains. Capital gains would cease to be assessable in steps - 10% for each of the first 10 years that the asset is held.

Further, I would quarantine negative gearing losses against the cost of the asset, only to be used to reduce the gain on the asset at the taxing point (that is the excess costs would go into what is now the 'cost base'). I think the system I've just explained would achieve this on general principles, but I'd allow specific provisions to pick up the slack.

(e) Greater alignment of accounting profit and taxable income.

This always seems like a good idea until one realises that Parliament would have outsourced its tax base to the gnomes who come up with Accounting Standards (often not even in Australia).

Perhaps we could start with accounting profit and require variations by regulation.

There are obvious efficiencies for business in doing this.

2. What is a sensible framework for Australian policy makers to use when thinking about the taxation of **international investment (inbound and outbound)** in the modern global economy?

Dividend and interest withholding tax should both be set at 30% but should both be allowed to be reduced (if not limited by a DTA) by franking the return (coupon). Thus Australian Tax credits would have to be used up to save the recipient having to pay withholding tax at the same level.

Often our DTA's limit the amount of Australian WHT that can be charged (say to 10% on dividends). But the relaxation of the franking rules I've mentioned above would allow the dividend to be franked so that only 10% tax is used.

Likewise WHT on Royalties is already set at 30% (subject to DTA's) but maybe royalties should also be able to be franked to avoid our withholding tax.

It seems we have to have a CFC accruals style of tax, but does it have to be so complicated. I hear that the NZ equivalent is a couple of pages. Could principles based drafting do something about getting rid of the complexity -

hopefully to staggering proportions.

Thin capitalisation requirements could be scrapped under the system I’ve described above.

3. In practice, **how important is Australia’s headline corporate tax rate** in attracting foreign investment, relative to other aspects of the tax system that affect the final company tax burden?

I can’t really say.

Corporates know how to do their sums.

On the other hand, my instinct is that it does matter.

4. What do you see as the **key issues in Australia’s international tax settings**?

If there were a way to get the headline corporate rate down to 10% or 20% like Ireland or England that would make a big difference (I think).

Not only would it attract investment but it would make our transfer pricing provisions largely irrelevant as taxpayers would be booking their income in Australia and taking their deductions in higher taxing countries so far as they could (and so long as we remained at the very low end of world corporate rates).

This might not be so hard if one remembers that corporate tax is really just a withholding tax under a franking system.

Low corporate tax rates would, however, exacerbate the amount of ‘top-up’ tax shareholders would have to pay (with commensurately lower franking credits).

Thus a Div 7A equivalent would still be necessary, but hopefully no where near as complicated. The combined professional bodies have advocated that arrangements currently deemed to be a dividend under Div 7A, should be deemed to be a loan (if they are not already that) with a deemed interest rate payable by the recipient and assessable to the company. Then then if the deemed loan were not applied for income earning purposes, the interest would still be assessable to the company, whilst the interest was not deductible to the shareholder/associate. With personal tax rates still appreciably higher, this might bight.

Perhaps other ‘checks and balances’ could be thought of. For instance, dividends franked at say the current corporate rate (of 30%) could be re-invested in the company so that it counted towards the cost base of the shares and did not attract tax at a rate higher than would be covered by the franking credit.

This would limit taxpayer’s tax rate to 30% which could well act as an incentive for many shareholders to re-invest.

5. In what circumstances, if any, is it appropriate to **adjust our international tax settings to cater for particular types of investors**, particular forms of investment (e.g. FDI vs portfolio) or to channel investment into particular sectors of the economy?

I can’t say, save to note that if the other things I’ve advocated were done, there might be much less that has to be done by way of incentive.

6. What are the **key taxation issues impacting Australian based companies in terms of expanding offshore**? How significant are these tax issues relative to other, non-tax issues that may be limiting offshore expansion?

I can’t really comment on either issue, save to say that MNE’s must be able to reward investors in a tax efficient fashion.

I understand that Australian franking credits cannot be given for another country’s tax but this is a problem.

A broad ‘foreign tax credits’ system that at least reduced the Australian company’s tax by that amount would be a good start.

Then a low ‘headline’ corporate rate might help.

It might leave profits effectively trapped in the company, but they would swell the value of the company and shareholders could access value by selling shares at a higher price.

7. Is the **dividend imputation system continuing to serve Australia well**?

Yes.

Regards

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