Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

1 June 2015

Dear Sir/Madam

Detailed PwC Submission – Tax Discussion Paper

PwC welcomes the opportunity to provide comments on the *Re:think Tax Discussion Paper*.

This submission should be read in conjunction with our submission, *The pathway to a better tax system* (attached), which considers the need for tax reform in Australia and the process through which it can be achieved.

Detailed analysis of existing taxes is a necessary step in the tax reform process. However, it is critical that any reform starts with holistic design principles that seek to address the key elements of what the Australian tax system should achieve. The tax system should:

- enable a healthy government
- support an efficient federation
- be fair
- be efficient
- be internationally competitive, and
- support economic growth.

This submission sets out our detailed comments on the questions and issues raised in the *Re:think Tax Discussion Paper* in the following appendices:

Appendix A: Detailed Submission

Appendix B: References to discussion questions

PwC remains committed to tax reform and we welcome the opportunity to discuss these submissions with you further.

Yours sincerely

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Appendix A

Detailed Submission

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1. Individuals

Australia has a high reliance on income taxes, and it is acknowledged that the direct taxation of individuals is a significant and stable source of Government revenue. There are, however, opportunities to reform the tax treatment of the earnings of individuals in Australia with a view to encourage workforce participation and promote simplicity and efficiency in the income tax system.

A significant concern with the taxation of individuals is the current "bracket creep" in our personal tax system. Bracket creep is found to be highly regressive as the increase in average tax rates is greater for those on lower incomes. It can also undermine work incentives for those on low incomes and can create incentives for tax minimisation by higher income earners as a consequence of incurring higher income taxes as earnings increase, even where incomes, in real terms, remain relatively stable.

The impacts of bracket creep are demonstrated in our analysis in Table 1 below which shows that the average income earner faced a marginal tax rate of 30 per cent in 2010, yet they now face a marginal tax rate of 37 per cent.

Table 1: Average and marginal tax rates due to bracket creep, average annual earnings

Year	Average annual earnings	Average tax rate	Marginal tax rate
2000[1]	$41,501	25.2%	43%
2001	$43,815	21.7%	30%
2010	$66,310	20.7%	30%
2015	$80,179	22.0%	37%
2020	$99,412	24.9%	37%
2030	$152,827	29.1%	37%

Source: PwC Analysis based on Average Weekly Ordinary Time Earnings (ABS Cat 6302.0)

Accordingly, it is our submission that the immediate effects of bracket creep on the labour force highlight the urgent need to review and address it in the context of all other tax reforms.

1.1. Tax planning and integrity rules for individuals

The expression "tax planning" needs to be clarified before responding to the question raised in the *Re:think Tax Discussion Paper* about the extent of tax planning[2]. All taxpayers inevitably do some tax planning in the sense that tax has a meaningful impact on most financial transactions, whether salary, business income, or other things like buying or selling major assets. Put simply, an example of not planning for the tax implications of a transaction would be selling an asset and spending all of the proceeds without calculating the tax that will be due potentially in 12 months' time once the tax return is lodged.

Tax laws are very complex, and even fairly straightforward transactions can have complex tax outcomes. In this context, tax planning is essential.

However "aggressive tax planning" is a very different thing, and to most people, this probably means tax avoidance activity. In this context, there are very extensive integrity measures that can apply to individuals - to name a few, the deemed dividend rules applicable to shareholders of private companies, the general anti-avoidance rules, personal services income rules, non-commercial loss rules, family trust elections, loss recoupment rules, prepayment rules, capital protected loan rules, substantiation rules, and the depreciation cost limit for luxury cars.

[1] The fall in average and marginal tax rates between 2000 and 2001 are attributed to changes to personal income tax arrangements associated with the implementation of *A New Tax System* by the Howard Coalition Government.

[2] Question 12, *Re:think Tax Discussion Paper*, p 43

There is much public commentary about tax planning by wealthy taxpayers, and which is often misinformed. In our experience, wealthier taxpayers generally accumulated their wealth over a lengthy period of time by taking prudent and conservative financial decisions, and paying their annual tax when due. The Australian Taxation Office (ATO) has been closely examining the affairs of nearly 3,000 wealthy family groups for long periods of time – up to 20 years, or more in some cases. Families who control substantial wealth are obvious "targets" for ATO audit activity, and given the array of anti-avoidance legislation available to the ATO, and the ongoing scrutiny by the ATO of their tax affairs, it is understandable that they take conservative positions.

It should also be noted that while a person is accumulating their wealth – such as a senior executive on a high salary – there is little scope for tax planning (apart from negative gearing, which in our experience many executives do not do). This means that those taxpayers pay the top marginal tax rate on most of their incomes and the tax profiles of different taxpayers (and the annual tax paid) can vary widely without there being any "aggressive tax planning" involved.

It is not our experience that there is a significant problem with tax planning in Australia by individuals and high wealth family groups. Tax laws are very complex, and some tax planning is essential. The existing integrity measures are extensive and appropriate to deal with incidents of aggressive tax planning, and we are not aware of any call from the ATO for large scale changes to the tax avoidance provisions applicable to individuals.

1.2. Assistance in the tax system through tax offsets

In our view tax offsets are appropriate for the delivery of assistance only where that is more economically efficient than providing assistance through the transfer system. Ideally they should not be used as tools to deliver wider social policy benefits, such as the Family Tax Benefit.

There is clear efficiency from a compliance perspective to deliver some forms of assistance through the income tax return process. For example, delivery of the franking credit to individuals is efficiently delivered through the tax offset mechanism applicable upon assessment of the income tax return which includes the franking credit as part of the assessable income calculation.

Means-tested tax offsets can act as a disincentive for workforce participation for middle income earners where their diminishing entitlement at various income thresholds can produce high effective marginal tax rates, so arguably these would be better delivered through the transfer system.

1.3. Work-related deductions

The current system applying to work-related expense deductions strikes a good balance between record-keeping requirements and practicality (for example, taxpayers have a choice of methods for deducting car expenses, depending on documentation levels).

The current system is fair because if taxpayers incur work-related expenses in the course of their employment, and keep the required records, they are entitled to claim the appropriate deductions. This is no more onerous than what employers have to do in relation to any similar costs which they incur in respect of employees.

The modern workforce is moving increasingly to individual choice (including "BYO" device policies) so it is not surprising that the level of work-related deductions have shown an increasing trend in recent years. This does not necessarily indicate a problem. If deductibility were denied to individuals then the cost would immediately shift to employers to provide these items to employees as work-related tools or employment support.

While the Australian work-related deduction rules could not be described as "simple", they are very well established and reasonably well understood by taxpayers and their tax accountants. The ATO has very good explanatory material on its website, and lots of relevant public Tax Rulings and Determinations[3] which are readily accessible to individuals. There is plenty of supporting case law.

Under the 2015-16 Federal Budget[4] two of the simplified methods for claiming car expenses are to be abolished from 1 July 2015 on the stated grounds of "cost of compliance". These two methods (the 12% of cost and the 1/3 of expenses methods) permitted simplified record-keeping for taxpayers who found the full "log book method"

[3] For example, Taxation Rulings TR 95/14 – employee teachers and TR 96/15 – nursing industry employees
[4] 2015-16 Budget Paper No. 2, Revenue Measure – Personal income tax – modernising the methods used for calculating work-related car expense deductions

too onerous. These two methods permitted a "trade-off" of easier records for lower deductions. Approximately 50,000 taxpayers were identified by the ATO as using these methods, far fewer than the approximately 3 million taxpayers[5] who use the other methods (log book and cents-per-kilometre) and it seems this was the main reason for the change of policy. (Note that the extent of the use of these methods may be understated because it would not include claims by partners as they disclose any claim for car expense deductions against their partnership income/loss in the individual tax return.)

Nevertheless 50,000 taxpayers is a substantial number, especially as we are not aware of any calls from taxpayer representative groups or the ATO for abolition of these two methods, or indeed any compliance issues of note that have arisen in the nearly 30 years since these methods were enacted.

Abolition of these two methods may force affected taxpayers to adopt the log-book method, which will thereby *increase* their compliance costs. Perversely, the log book method tends to produce higher tax deductions, so there may well be a result of lower tax paid as a result of this change. We submit that no change is necessary.

If a degree of simplification is desired in the area of employee deductions then we alternatively suggest that consideration be given to allowing taxpayers to have an optional "standard deduction" in lieu of all claims for work-related deductions. This could be adjusted in accordance with levels of income (proportionately higher deductions for higher income levels). However we stress that this should not be compulsory. There would be significant structural dislocation if employees suddenly had to renegotiate their employment contracts to replace the lost deductions for legitimate work-related costs. On balance however we do not support such a change as it would advantage those who do not incur substantial deductible expenses and it would disadvantage taxpayers who do legitimately incur such expenses.

The existing $300 substantiation limit already operates in a similar way and has brought some discredit to the existing rules due to a perception that some taxpayers claim $300 without incurring any expenses. While some might argue that for that reason, this concession should be abolished, it has existed for over 25 years and has not been the subject of general abuse. The ATO already has statistical analysis tools to identify cases of abuse by particular accountants or industries. Accordingly, we do not support abolition of this rule.

1.4. Fringe Benefits Tax

The current fringe benefits tax (FBT) system is a robust tax collection framework, evidenced by the ATO's low level of audit activity compared with other taxes and supported by the existence of associated compliance frameworks, such as the reportable fringe benefit system. Whilst it constitutes a relatively small component of the Australian Government's total tax collection, it serves an important role in preserving integrity to the taxation of remuneration, specifically non-cash benefits.

The debate around the current FBT system, as to whether it is an effective tax collection mechanism, centres on two fundamental concerns, being:

- Fairness and equity - the inequity caused by the imposition of a flat FBT rate levied at the highest individual marginal income tax rate on benefits provided to employees who may often be on lower marginal income tax rates, and
- Simplicity - the significant administrative burden associated with complying with the FBT laws.

The replacement of the FBT system on employers by taxing benefits in the hands of employees continues to be raised as a viable solution to the above concerns. This suggestion seems to be based partly on the misconception that the majority of fringe benefits form part of a salary packaging arrangement. In truth, over the past decade, the concessions that facilitated salary packaging have been steadily eliminated or reduced by Government, such as cars, living away from home allowances, in–house benefits and on-site canteen meals. Based on FBT returns reviewed by PwC, the majority of benefits giving rise to an FBT obligation are non-remuneration related benefits, being benefits provided to employees in the course of performing their employment role, such as fleet/tools of trade cars, meals and other entertainment, or benefits to place employees in a location to fulfil their work commitments (such as relocation, fly-in fly-out travel or living away from home expenses – noting that these benefits are not always exempt).

[5] ATO Taxation Statistics 2012-13, Detailed tables, Individuals, Table 1, extracted from https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2012-13/?page=22#Individuals, 22 May 2015

We consider that the transfer of tax collection from the employer via the FBT to the employee via the income tax system does not resolve the combination of the abovementioned concerns.

To support this position, you need not look any further than the level of non-compliance and tax leakage that necessitated the introduction of the FBT system. This would likely again emerge if the taxation of benefits was transferred back to employees, particularly under a self-assessment environment. An alternate system of taxing employees but making employers manage the administration is just the current FBT system under a different façade – it would not fix the existing administration concerns, rather likely exacerbate it. And this does not address the taxation of non-remuneration benefits. A hybrid system may be necessary to tax the non-remuneration benefits. Again, this would not simplify the tax system.

The two fundamental concerns with the existing FBT system are best addressed by alternate targeted measures (discussed below at section 1.4.1).

1.4.1. *Simplicity and fairness in the FBT can be improved*

The current FBT system seeks to deliver fairness at the expense of simplicity. Significant control and substantiation measures exist to ensure that more tax is collected, rather than less. However, the application of the flat FBT rate equal to the top individual marginal rate of tax also leads to the view that FBT fails the fairness measure.

Our recommendation is to continue with the existing FBT system, with suggested alternate targeted measures to make the system fairer and simpler comprising:

- Fairness and equity – assessing employers at an FBT rate per employee commensurate with the level of gross salary plus benefits. Employers already have to assign benefits to employees under the reportable fringe benefit system, so the additional step to apply the tax is not oppressive. Non-remuneration benefits could attract an FBT rate equivalent to the corporate income tax rate. A similar system already exists in New Zealand.
- Simplicity – specifically target administrative simplification. This process has already commenced with the ATO's consultation process on FBT and Remuneration Safe Harbours[6]. The Assistant Treasurer's announcement[7] on 1 May 2015 providing additional statutory remedial powers to the Commissioner of Taxation provides another mechanism to resolve in an efficient manner unintended administrative burden under the current FBT system. The Board of Taxation has also recently established a consultative committee in relation to deregulation of FBT, involving both the ATO and Treasury.

Both of these suggestions deliver good tax outcomes in that they collectively deliver an outcome that is simpler and fairer, without returning to a system that historically has, and prospectively would, likely present considerable challenges.

Also refer to our comments in section 1.5 below regarding FBT in the context of a globally mobile workforce.

1.4.2. *Concessions and exemptions in the FBT system*

Concessions and exemptions within the fringe benefits tax system can largely be grouped into the following categories:

1. **Those to achieve simplification in administration** – typical examples being the statutory formula valuation method for cars, the 50/50 method for meal entertainment and entertainment facility leasing expenses, the minor benefit exemption and those for obvious work-related expenses (eligible work-related items and benefits covered by a "No Private Use" declaration).

2. **Those to remove taxation from immaterial or incidental benefits** - typical examples being the minor benefit exemption, long service awards and use of facilities on business premises.

[6] Australian Taxation Office, 30 April 2015, *Matters under consultation – Administration: [20512] FBT and remuneration safe habour*, https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/Matters-under-consultation/Administration/#FBT201512
[7] Assistant Treasurer's media release, 1 May 2015, *Providing more certainty and better outcomes for taxpayers*, http://jaf.ministers.treasury.gov.au/media-release/021-2015/

3. **Those to remove taxation from employment necessitated expenses -** typical examples being living away from home and relocation expenses and work-related expenses (eligible work-related items provided predominantly for employment-related purposes).

4. **Those to provide equality with the income tax system -** typical examples being the otherwise deductible rule and operating cost (log book method) for cars.

5. **Those to support employers within particular industries** – typical examples being charitable institutions, various not-for-profit associations and public hospitals.

It is our view that the concessions and exemptions listed under items 1 to 4 above are appropriate, measurable against the standards of a good tax system being simpler and fairer. We are of the view that further simplification of substantiation measures for exemption eligibility could be undertaken (as highlighted at section 1.4.1 of this submission).

In relation to the concession/exemption category, refer to our comments in section 5.2 in this submission.

1.5. *Tax affects global mobility*

When considering the impact that Australia's tax system has on a globally mobile workforce, it is imperative to address any features which may impede growth, employment and innovation in Australia.

In our experience, tax is an important factor in determining people's decisions to work in Australia or other countries. Although there is an expectation that financial situations will be complicated by working abroad, there also exist a degree of complexity and the absence of clarity around the tax laws as applicable in Australia and their interaction with the laws in other countries, as well as the interaction between the income tax and fringe benefits tax regimes which are unique to Australia. The tax aspects of global mobility accordingly need to be considered not only from the individual's perspective but also from the employer's perspective.

1.5.1. *Tax as a barrier to mobility*

A report co-authored by PwC and Cranfield Graduate School of Management, *Understanding the Barriers to Global Mobility*, found that from an employee's perspective, financial matters, while important, rated behind the opportunity to grow leadership skills and other personal potential. From an employer's perspective, the decision as to whether to send someone on an assignment is firstly considered in light of the financial impact.

It is our experience that employers throwing money at the barriers to international mobility is expensive and creates a cost ratchet effect, which in many cases is unnecessary if an overseas opportunity can be represented in the right career perspective and there is true understanding of the motivation of the individual to work overseas and ultimately to return home.

Organisations are preoccupied with the influence of the assignment financial package in the decision to relocate an employee, and often are underestimating the importance to the individual of the financial package on their return. In any employee reintegration review, the financial package features as a critical issue to individuals who are expecting to "cash in" on their international assignment experience upon return to their home jurisdiction. Workers may find that they get used to a certain level of after-tax income which will be less upon returning to Australia.

One reason that employers are more focused on the financial impact has to do with the fact that the inputs can be measured. That is, the cost of having a worker overseas can be identified by adding together the cost of items such as visas, medicals, flights, tax assistance, language assistance, cultural briefings, housing and vehicles. What cannot be quantitatively measured are the benefits (i.e. development, growth, additional skills, increased attractiveness as an employer etc) from having a worker overseas and the incremental benefits from having an employee who returns to their home jurisdiction.

It is important to note that financial impact is not just the direct costs associated with moving workers overseas, such as visas, but also the indirect costs of tax and tax compliance. The Australian-African Mining Industry

Group (AAMIG) recently made a submission[8] to Treasury on the impact that the narrowing of the tax exemption on income earned in overseas employment in 2009[9] and the changes to the FBT living away from home allowance (LAFHA) rules in 2012 has had on Australian businesses.

In summary, the findings of the AAMIG survey found that:

- Since the amendments to the income tax exemption for foreign earnings in 2009, there had been a definite increase in the cost of sending Australian employees overseas.
- Many employers no longer employ Australians to work on overseas assignments, preferring, for cost reasons, to employ nationals from more tax-effective jurisdictions (South Africa, Europe and North America), even if this does not provide the best overall commercial outcome.
- The primary reason for Australian companies failing to win overseas contracts was cost, particularly employee costs.
- Employers had noted an increase in employee costs, primarily arising from the requirement to cover additional tax liabilities incurred by an Australian employee working overseas.
- A number of Australians working overseas had relocated their home base to more favourable jurisdictions around the world, effectively making them non-residents for Australian tax purposes owing to the higher tax rates imposed by Australia, coupled with the lack of tax concessions made available for those working overseas.

Overall, the significant reduction in scope of the foreign earnings exemption, coupled with the tightening of the FBT concessions for LAFHAs have put Australian companies at a competitive disadvantage when attempting to secure international work or to attract international employees. Arguably, this has a result that Australian companies can suffer losses from growth and also a potential loss of skill development of Australian expatriates.

While there are other 'non-tax' factors contributing to this non-competitiveness, the current application of the tax rules requires further review with the objective of developing a more concessionary and administratively less burdensome approach to the taxation of foreign earnings and the FBT treatment of benefits associated with relocation or living away from home.

1.5.2. *Complexity of compliance*

There are a number of complexities in the application of the tax law which arise for individuals when they go to work overseas or come to work in Australia such as:

- Determining the individual's tax residency in Australia or the foreign location. This is complex enough if only two countries are involved. If the role of the individual involves multiple jurisdictions, or they hold citizenship in a country such as the United States which requires filing of returns no matter which country one lives in, residency can be very complex. Residency needs to be established so that taxing rights can be allocated between the countries. The determination of an individual's residency or otherwise in Australia has been complicated in recent years with changing lifestyles and social settings of the current globally mobile workforce, but taxpayers are faced with little current judicial and administrative guidance[10]. Furthermore, it has been our experience that we are seeing many more issues of residency being questioned by the ATO which has resulted in lengthy, time consuming, and often costly, disputes. In this respect, we suggest that there would be merit if there were updated guidance from the ATO to assist taxpayers (and their employers) have greater certainty of their residency status.
- Once residency is determined, and in the situation where an individual is a resident of more than one country according to the relevant domestic laws, there is often a need to then consider the potential application of a double tax agreement with Australia, if applicable, to ensure that there is no double taxation of the income earned by the individual. Arguably, the layman would not be aware of such agreements and how to apply them without seeking professional tax advice.

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[8] Australian-Africa Mining Industry Group, May 2015, *Compelling case for a review of employee taxes for Aussies in Africa*, http://aamig.com/2015/05/compelling-case-review-employee-taxes-aussies-africa/
[9] Section 23AG of the Income Tax Assessment Act 1936
[10] The ATO has not offered more guidance than two old tax rulings – IT 2650 issued in 1991 and TR 98/17 - and the existence of two old judicial decisions - FC of T v Applegate 79 ATC 4307; (1979) 9 ATR 899 and FC of T v Jenkins 82 ATC 4098; (1982) 12 ATR 745

- Once residency and tax source has been determined, the individual needs to calculate the taxable income on the basis of the financial year of each country in which they need to report to the relevant tax authorities. For individuals, Australia has a financial year ending on 30 June which is different to the majority of countries that have tax years ending on 31 December. The complexity arises for example, when an individual receiving a payment summary from a foreign employer needs to reconstruct it for the Australian tax year. This takes time by the individual to go back to source documents such as payslips. Additionally, determining whether certain pre-tax deductions and other benefits are taxable for Australian purposes creates much anxiety and often leads to either over-statement or under-statement of taxable income.
- A law change in recent years related to foreign tax credits has also added to complexity. Now, foreign tax credits can only be claimed in Australia on a paid (as opposed to payable) basis. This means that Australian taxpayers have to wait until after the foreign return has been lodged to determine the tax claimable in Australia and this timing difference can be lengthy. Some individuals have opted to pay the tax in Australia so that they satisfy the filing deadlines in Australia without penalty, and then amend the Australian return for a refund of the foreign tax credits, after the foreign return has been lodged. For example:
  - An individual works overseas in the United States from January 2015 to April 2015.
  - The 2015 Australian tax return is lodged by 31 October 2015 reporting foreign income and tax is paid when due.
  - The 2015 United States tax return can be lodged as late as October 2016 and tax is then paid in the United States.
  - In October 2016 (18 months after assignment ended), the individual would request an amended income tax assessment to claim the foreign tax credit for the 2015 Australian tax year.
  - There is a duplication of tax payments until the amended 2015 Australian tax return is assessed by the ATO.
- There were concessions such as enabling the foreign equivalent of PAYG withholding to be deemed to be paid, even where a year end filing may result in some of the withholding being remitted to the taxpayer.

It is our recommendation that consideration be given to addressing some of the complexity as noted above by reinstating the foreign earnings exemption (section 23AG) as it was prior to the changes made in 2009 – this would have the impact of charging the right amount of Australian tax on income other than foreign employment income which would have been subject to tax in the foreign location.

1.5.3. *Income tax and fringe benefits tax*

As mentioned briefly above, workers on a global assignment may receive remuneration in the form of benefits. Where this income remains taxable in Australia, the individual and their employer need to determine whether the non-cash remuneration should be reported for Australian income tax (by the individual) or FBT (by the employer) purposes. Greater certainty could be achieved for all taxpayers through ATO guidance, however, there has been very little guidance given to date by the ATO on this issue. Our recommendation is to consider disregarding the value of the benefits that are provided by a foreign employer as the cost is not easily accessible or identifiable by the individual when paid by their employer in lump sums to providers such as airlines and in the form of on-site accommodation.

2. Savings

The tax treatment of savings varies significantly across different forms of savings. This inconsistency was noted in the Henry Review, which found that "*... tax outcomes for different types of savings vary considerably and have evolved in an ad hoc manner. How households allocate their savings between different assets or savings vehicles is likely to be significantly affected.*[11]"

The most current data available from the Australian Bureau of Statistics[12] estimates that most household saving, excluding owner-occupied housing, is concentrated in superannuation (15.4%) and property (15%), with only 4.8% held in bank and offset accounts and 2.5% held in shares (excluding own incorporated businesses) and public unit trusts. The preferential tax treatment of superannuation and property is likely to contribute to bias toward these forms of savings. In some cases, preferential tax treatment is the result of a deliberate policy decision to encourage particular behaviours (for example, the tax treatment of superannuation). However, in some instances, the differential tax treatment of savings can result in a distortionary effect on the allocation of resources.

With this in mind, PwC supports a review of the taxation of savings as a whole, based on the following principal outlined in the Henry Review:

> *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.*

In addition, any reform to the taxation of savings needs to be simple to apply and administer having regard to costs of compliance.

2.1. Bank accounts and debt instruments held by individuals

Reforms could be made to the tax treatment applicable to bank deposits and other debt interests in the interests of promoting simplicity. For example, through a simpler approach to dealing with the taxation of interest on bank deposits, where financial institutions are already in possession of taxpayers' tax file numbers, and are providing the ATO with annual interest income data in respect of every taxpayer with a bank account, there is an opportunity to streamline the income tax assessment process for many individual taxpayers who have no other form of earnings other than salary and wage income. For instance, could a final form of withholding tax apply and/or could there be some form of de minimis threshold applicable to very small interest earnings? Such proposals should be considered in the interests of easing the compliance burden with the view to removing a significant number of individual taxpayers from the requirement to lodge income tax returns. That alone could be a significant productivity boost to Australia.

The rules which deal with foreign exchange gains and losses[13] are unnecessarily complex. Furthermore, it is our experience that more and more individual taxpayers are exposed to foreign currency. For this reason, we submit that consideration should be given to narrowing the number of individuals affected by these rules. The Limited Balance Exemption[14] applicable to foreign currency denominated bank accounts with balances that do not exceed a prescribed legislated threshold could be increased, and/or provide an exclusion for non-business transactions.

Passive investments could have the foreign exchange impact switched into the capital gains tax (CGT) calculation when an asset is disposed of. There are serious anomalies which can arise – for example where a foreign currency borrowing to purchase a foreign asset (i.e. natural hedging) gives rise to foreign exchange losses on the loan (which are fully tax deductible) and the offsetting underlying foreign exchange gains on the asset are eligible for the 50% CGT discount. Equally, there is an anomaly where foreign exchange gains on the loan are fully assessable, and foreign exchange losses on the asset give rise to a capital loss which may have to

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[11] *Australia's Future Tax System report to Treasurer Part Two*, December 2009, p 68
[12] Australian Bureau of Statistics, August 2013, *Household Wealth and Wealth Distribution, Australia, 2011-12*
[13] Division 775 of the Income Tax Assessment Act 1997
[14] Subdivision 775-D of the Income Tax Assessment Act 1997 applicable to qualifying forex accounts

be carried forward to future years if there are no other capital gains in that year. This is an unsatisfactory tax policy outcome in circumstances where the taxpayer has made no overall economic currency gain or loss attributable to currency movements.

Similarly there are inequities with timing due to the differing taxing points between the foreign exchange rules and the CGT rules.

There are additional timing issues which arise due to foreign exchange tax events occurring regardless of realisation – such as a mere rollover of a term deposit. Unrealised gains and losses are immediately taxable/deductible regardless of the economic realities.

2.2. The CGT discount and negative gearing

The CGT discount is Australia's version of the worldwide tendency for preferential taxation of gains from investment. It is a common under-pinning of many modern taxation systems (including economies such as the United States and the United Kingdom). Some close neighbouring countries (such as New Zealand) do not have a capital gains tax. On this basis, it may be considered that the CGT discount is still appropriate, particularly due to the modern reality that capital is inherently and increasingly mobile.

We acknowledge that CGT discounts accrue mostly to higher income taxpayers, but observe that the CGT discount is available to virtually all individual taxpayers indirectly through their superannuation funds, which receive a 33.3% CGT discount.

There has been some criticism about whether the zero discount available for CGT assets owned for less than 12 months is too low, and whether the 50% discount for those held more than 12 months is too high. In our view there will always be a degree of arbitrariness in these thresholds, but we think that the zero discount rate is designed to avoid unnecessary speculative activity, and it also aligns to similar international distinctions between short term and long term gains.

Some commentators have advocated a smaller or more graduated scale of discount depending upon the number of years the asset is held, however we see this as adding significant further complexity in the tax system without adding meaningfully to achieve fairness. Others have called for a return to indexation, however this was abandoned due to its significant complexity[15], and in our view should not be reintroduced if it does create complexity.

Recent changes to make the CGT discount available only to tax residents have a reasonable theoretical and policy foundation. We note that they have, however, also added significant tax complexity to the affairs taxpayers who move overseas.

Negative gearing has received much commentary in the media, often poorly informed. Tax integrity rules (such as the capital protected loan rules and other prepayment limitation rules[16]) introduced over the last 25 years have limited the scope of negative gearing to apply to very "vanilla" investments in income-producing real estate, listed and widely held securities. Furthermore, net investment losses which emerge from negatively geared investments are taken into account in applying income tests for entitlement to other transfer benefits such as Government assistance or other tax concessions or tax offsets.

Fundamentally, taxpayers understand that losing money annually, even if it is tax deductible, is a cost and a cash outflow which they do for a reason. Just like making contributions to superannuation (within relatively modest concessional contribution limits), which is also tax effective, there is a cash outflow from current disposable income in the expectation that they and their children will enjoy longer term prosperity.

It should be acknowledged that a large component of the deductions available to property owners (whether negative geared or not) are the building allowance and plant depreciation deductions, which contribute to much of the resulting tax loss arising from a property investment.

There are widely divergent views being expressed about the impact of negative gearing on the housing market. These include its impact on the supply of new housing, renewal and renovation of existing housing stock, the

[15] Treasurer's media release (No 58), 21 September 1999, *The New Business Tax System*
[16] Division 247 of the Income Tax Assessment Act 1997 and Subdivision H of Division 3 of the Income Tax Assessment Act 1936

effect on house prices, the prevalence of foreign investment in real estate, and so on. Yet there is very little agreement on the overall effect which the availability of negative gearing has on the wider economy, both in macro and micro economic terms[17]. In the absence of convincing data and analysis, we are of the view that policy restraint should be exercised until clear data and analysis is available regarding the wider economic impacts of negative gearing.

As highlighted in the *Re:think Tax Discussion Paper*, much of the potential tax advantage from negative gearing an investment property rests in the taxation of the capital gains on disposal of the asset, and by extension, on the availability of the CGT discount[18]. Accordingly, we recommend that any possible reform to negative gearing should be conducted as part of a more holistic review of the tax treatment of a broader spectrum of income earning investments rather than merely focusing on real estate investment in the major cities of Sydney and Melbourne. This should also include the impact that other tax regimes, such as land tax, has on the provision of capital in the property rental market.

2.3. Superannuation

The *2015 Intergenerational Report* indicates that by 2055 there will be a growing percentage of the Australian population that will be over age 65, and combined with an increased life expectancy of males and females, there will be pressure on government for both health and aged care facilities[19]. This will also place further pressure on government to fund age pensions if retirement savings are not sufficient.

The purpose of the Australian superannuation system is to provide an additional mechanism for the population to save for their own retirement which no doubt will serve to reduce the pressure on the government to fund age pensions. The *Re:think Tax Discussion Paper* indicates that it is expected that superannuation benefits for low and middle income earners will make up a larger part of their retirement income in the future[20].

It is important that any tax changes to superannuation increase fairness and reduce complexity. However, because it is an individual's long-term savings that are at stake, any changes need to be carefully considered and any case for change as part of a reform of the tax system would need to be clearly communicated and understood by all stakeholders. To encourage people to save for a long term into the future, people need confidence that their savings will be available for their retirement in a form consistent with the basis on which the savings were made.

It must also be recognised that superannuation savings is just one form of an individual's savings and it needs to be considered as part of a complete balanced savings portfolio that may support future income streams. Accordingly the overall tax outcomes need to be factored in planning for an individual's retirement, including the impact of any other tax reform measures outside the superannuation system.

The current taxation system for superannuation raises revenue at two taxing points: at the time concessional contributions are made and on earnings in the accumulation phase. Earnings in pension phase and on the withdrawal of benefits from superannuation from age 60 are tax free.

We support this fundamental regime and that superannuation savings should continue to be taxed concessionally compared to savings outside the superannuation system, but we recommend that consideration be given to making some changes to the current taxation of superannuation to make it more equitable.

2.3.1. Tax incentives to encourage self- funded retirement

We support compulsory superannuation guarantee (SG) contributions levied on salaries as it forces a minimum level of savings. We recommend that consideration should however be given to introducing compulsory superannuation on those who are self-employed. However, in order for people to save a level of funds over and above the SG amount, tax incentives should continue to encourage voluntary savings.

We believe the current concessional contributions caps per year of $30,000 for those under age 50 and $35,000 for those aged 50 and over are too restrictive. We recommend consideration of the following changes in relation to contributions:

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[17] See for example, Senate Standing Committees on Economics *Affordable Housing Report*, tabled 8 May 2015
[18] *Re:think Tax Discussion Paper*, 30 March 2015, p 66
[19] Australian Government, March 2015, *2015 Intergenerational Report*
[20] *Re:think Tax Discussion Paper*, 30 March 2015, p 70

- have a lifetime tax concessional contribution cap rather than a yearly cap
- the quantum of the lifetime concessional contribution cap should be based on the level of savings required to provide the average person a comfortable living standard in retirement
- remove the 10% rule for personal deductible contributions to increase the accessibility to the concessional cap, and
- increase the age at which a person can access the "bring forward" non-concessional contributions cap to age 70 to recognise that people are staying in the workforce longer.

This would create a fairer system as it will allow part-time workers and people with periods of leave from the workforce the same ability to access the tax incentives to encourage savings in superannuation, as someone who is working full time throughout their working life. It also reflects, that for many people, the ability to fully utilise the concessional contribution caps will occur in different periods of their working life. For example, people who are high income earners early in their career, such as professional sport people, would benefit from the tax concessions early in their working life, while many other people will only have sufficient cash flow late in their working life to fully utilise these tax concessions.

The concessional contributions tax of 15% should remain. However, in the interest of fairness and equity in the level of net tax concessions on contributions across the spectrum of low, middle and high income earners, the current additional tax imposed on taxable contributions[21] should be levied at a lower threshold than the current level of $300,000. The appropriate level that this should apply would need to be considered with regard to the personal individual marginal tax rates, so that the level of tax concession is similar for all income earners.

2.3.2. *Concessional tax environment of superannuation savings*

The concessional taxation of superannuation earnings must be preserved to encourage savings for retirement in this environment over other forms of savings in order to protect those savings for the long term. The lower tax environment will also allow these funds to accumulate at a greater rate and provide some buffer against inflation.

The *Re:think Tax Discussion Paper* comments that as more people enter retirement where no tax is paid on earnings, more pressure will be put on the budget to fund health and aged care[22].

We understand the difficulty in implementing wholesale change to the superannuation system. Not only would it be costly to implement a complete change to the taxation of superannuation, but any wholesale change would need to consider transitional rules for those individuals who have saved on the basis of the current system. On this basis we recommend the following:

- Continue to tax earnings at accumulation phase at 15%
- Restrict the level of member balances that can be crystallised and invested in the pension phase (i.e. an income stream product) that attracts the 0% rate so that high member balances (set at an appropriately considered level that has regard to the level of personal income tax rates) over and above this level continue to be subject to tax at 15% on pension phase, and
- Ensure no tax on withdrawals by persons in the pension phase (as is currently applicable).

The above changes should be relatively easy to implement for the superannuation industry as it is based on the current system. It does, however, raise tax by restricting the level of earnings that attract the nil rate of tax (addressing issues of equity and fairness), but does not necessarily reduce any complexity within the superannuation system.

A flat rate of tax at 15% should continue to apply to superannuation benefits on death of a member over a specified limit when paid to a non-financial dependant.

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[21] As imposed on certain higher income earners under Division 293 of the Income Tax Assessment Act 1997
[22] *Re:think Tax Discussion Paper*, 30 March 2015, p 69

2.3.3. *Accessing superannuation at retirement age or death*

In order to ensure that people do not accumulate funds indefinitely in the superannuation system in order to defer tax at withdrawal or death, we recommend that consideration be given to the following having regard to the impact of other reforms:

- maintain transitional rules for pensions to allow people to access a restricted level of superannuation whilst they are working part time. This will then prevent people from having to permanently retire from the workforce in order to access a greater level of income to support them
- introduce compulsory cashing of superannuation benefits from age 70 if a person fails the work test, and
- maintain the current position whereby superannuation is to be fully paid out on the death of the last surviving financial dependant to ensure it cannot be used as estate planning accumulation for the next generation.

3. General business income tax issues

International tax competition is alive and well as countries compete for global capital from businesses and set their individual tax regimes on what is economically good for their country. Australia is not immune from that challenge as a relatively small nation and open economy that is heavily dependent on imported capital. Accordingly we need a business tax system that can support a goal of Australia being an attractive and competitive place to do business. More specifically we need a business tax system that can position Australia in a way to attract and retain the companies and industries of the future and maximise our role in the Asia Pacific region.

If Australia's tax system gets out of step with the global community, we run the risk of discouraging business investment in Australia.

At the heart of this is the relevance of the company tax system – Australia needs an internationally competitive company tax rate along with a simple set of rules.

Our submission below broadly follows the core themes of Australia striving towards the objective of having a business tax system that:

- is internationally competitive, i.e. the overall business tax burden should be reduced to a competitive level
- fosters innovation, and
- is simple to apply and administer.

3.1. Company tax rate

At the outset, we submit that there is a strong case to reduce the current 30% rate of tax applicable to companies in Australia.

While past tax reviews that have considered the case for a lower company tax rate have failed in the sense that there has been no actual change in the 30% company tax rate since 2001, we consider that this has been a shortcoming of trying to achieve a revenue neutral outcome within the confines of the existing business income tax system[23]. The evidence is clear that this will not be achievable without considering the whole of the Australian tax system as set out in detail in our supplementary submission calling for a *Pathway to a better tax system*.

We agree with the economic data and analysis in past literature[24] and reviews[25] which suggest that high company taxes can reduce the level of foreign and domestic investment, the incentive to innovate, and in turn, have the consequences of reducing economic growth, productivity and real per-person incomes.

If corporate income taxes were reduced, economic activity could be boosted by a reduction in the hurdle rate of investments which will lead to improvements in the capital to labour ratio and productivity and will remove distortion so that the market allocates capital to areas with the highest return. It will also reduce the excessive reliance on debt levels compared to equity levels which will improve the fundamental strength of the economy and make Australia far more attractive to foreign direct investment across the broader economy.

PwC is strongly of the view that the tax system as a whole, and in particular, the company tax rate is an important aspect in assessing the attractiveness or otherwise of Australia as a place to invest.

Australia's corporate tax rate at 30% is one of the highest corporate tax rates in the Organisation for Economic Co-operation and Development (OECD)[26]. In addition, Australia has slipped from being ranked the 12th lowest in 2001 in the OECD's ranking of the overall company tax rate to its latest ranking of the 27th lowest.

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[23] See most recently, the Business Tax Working Group, November 2012, *Final Report*, paragraph 8 p iii
[24] L. Cao, A. Hosking , M. Kouparitsas, D. Mullaly, X. Rimmer, Q. Shi, W. Stark, and S. Wende, Treasury Working Paper, April 2015, *Understanding the Economy-Wide Efficiency and Incidence of Major Australian Taxes,* http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/working-paper-2015-01
[25] *Australia's Future Tax System report to Treasurer* , December 2009, pp 12-13; Business Tax Working Group, November 2012, *Final Report* , p ii-iii
[26] OECD Tax Revenue Statistics *2000 - 2015*. Updated April 2015

Throughout that period Australia's company tax rate has remained constant while there has clearly been a global trend which has seen a slow reduction in global company tax rates.

In the context of the Asia Pacific region, Australia's taxes on company profits are comparatively higher than the average for the region[27]. We need to recognise how our company tax rate compares with our regional neighbours and not lose sight of the effect that this may have on opportunities for Australia to compete for business in this region.

Arguably, Australia's natural resources (i.e. location specific) have provided a buffer over the years in attracting foreign investment, but for other industries which are highly mobile and of growing importance to the sustainability of the Australian economy[28], the current rate of company tax increasingly will be a key factor in securing new foreign investment into Australia and more importantly, retaining existing investment in Australia.

Australia should not be seeking to have the lowest company tax rate in the world. We agree with the principle established in the Henry Review that "company income tax is necessary to raise revenue on the normal return, as well as economic rents, earned by foreign capital invested in Australia and to maintain the integrity of income tax as it applies to Australian residents"[29].

The 2015-16 Federal Budget announcement[30] to reduce the company tax rate for eligible small business companies to 28.5% is a step in the right direction, but should be seen to be the start of a process to reduce the company tax rate more broadly.

While a corporate tax rate of no more than 25% would be ideal, the extent and pace at which the company tax rate can be reduced must importantly have regard to the fiscal restraints of affordability, other tax reforms and how to achieve an appropriate balance between the initial loss of revenue with the longer term incremental enhancements to other revenue sources through productivity gains and new foreign investment.

It needs to be acknowledged that this may take time and may come with some transitional burdens. For example, a rate reduction may need to staggered over many years and potentially apply at tiered rates according to the level of taxable income. Economic modelling of the overall burden and impact would need to be undertaken to ensure that its implementation was fair and equitable and fiscally sustainable in the short-term.

3.2. Dividend imputation

At the outset it must be understood that any decision in respect of the future of the dividend imputation system need to be addressed having regard to other tax reforms, in particular, reforms to the company and/or individual tax rate (e.g. a lower corporate tax rate reduces the benefits of the imputation credit), potential reforms to the superannuation and personal tax system, and the international tax landscape.

It has been well documented in current and past reviews[31] that there are pros and cons associated with Australia's current dividend imputation system and this is exacerbated by competing corporate interests, perspectives and tax profiles of individual shareholders.

We consider that the imputation system has served its primary purpose well since its inception and there remains a strong and clear case for its ongoing role in the tax system when considering the following facts:

- The dividend imputation system removes the "double" or "over" taxation issue by ensuring that Australian resident investors are only subject to tax on the underlying Australian company profit at their own marginal

[27] World Bank Group and PwC, *Paying Taxes 2015: The Global Picture* , refer to comparative modeler, http://www.pwc.com/gx/en/paying-taxes/download.jhtml
[28] The Australian services sector contributes almost 75% of GDP and employs 87% of Australia's workforce – Asialink Business, ANZ and PwC, April 2015, *Australia's Jobs Future* http://asialink.unimelb.edu.au/__data/assets/pdf_file/0010/1401688/Australias-Jobs-Future-The-rise-of-Asia-and-the-services-opportunity-Asialink-Business.pdf
[29] *Australia's Future Tax System report to Treasurer Part Two*, December 2009, p 150
[30] 2015-16 Budget Paper No. 2, Revenue Measure – Growing Jobs and Small Business – tax cuts form small business
[31] *Australia's Future Tax System report to Treasurer Part Two* December 2009, pp 191-204; *Re:Think Tax Discussion Paper*, March 2015, pp 82-87; and in the international context, the Board of Taxation, February 2003, *Review of International Tax Arrangements*

rate of tax when distributed (supports neutrality in the treatment of businesses conducted by incorporated and unincorporated entities)

- It encourages Australian companies to pay Australian income tax, i.e. promotes a company's self-interest in complying with Australian tax law, and
- It incentivises Australian residents to directly invest in Australian companies, as opposed to foreign companies, contributing to a stable capital market and a lower cost of capital for domestic firms.

A lot of the concerns with the imputation system centre on the international aspects. The limitations and biases of the imputation system in an international inbound and outbound context need to be weighed up objectively having regard to the extent to which Australian companies predominantly operate on a domestic basis and/or are owned by residents.

The interplay with other tax laws operating in Australia (e.g. the Australian company, individual and superannuation tax rates, transfer pricing and thin capitalisation rules, and the different CGT treatment for resident and foreign investors) or overseas (e.g. manner in which foreign tax relief is provided) are also relevant considerations in this context. With many varying factors at play the extent to which the imputation system might be the primary basis for any unintended biases becomes difficult to assess.

We do not consider that there is evidence to undertake major reform to the application of the imputation regime. In fact we believe all evidence strongly supports its retention. The current imputation system is well accepted and implemented by all of corporate Australia. However, there is room to improve its current operation. For example:

- Simpler franking credit trading rules – for example, having regard to the compliance burden that may be imposed in understanding and complying with the rules, revisit the current exemptions and ensure that the rules are included in the single Income Tax Assessment Act 1997, and
- Appropriate transitioning of franking credits when company tax rates may change, bearing in mind that there is a considerable amount of franking credits retained by companies that reflect a 30% corporate tax rate[32].

3.3. Capital assets

Although there has been a shift away from investment in tangible assets towards intangible assets (both in Australia and around the world), any reform of Australia's business tax system should address both types of capital assets.

The current tax treatment of capital allowances was significantly simplified and rationalised as part of the Review of Business Taxation (Ralph Review) where the law[33] was developed with the underpinning principle of ensuring that the tax write off of capital assets should assimilate the asset's effective life. We continue to support that approach, subject to our observations and comments below.

Although it is generally accepted on economic policy grounds that a business tax system should be neutral so as not to favour particular types of investment, it has been our experience that the tax treatment of capital assets does affect the extent and composition of investment in certain capital assets. Consider the following:

- the rate at which deductions are available for capital asset expenditure can affect the economic viability of many capital intensive projects and undertakings. This is particularly so for infrastructure assets and for certain mining investments, and
- incentives, such as the former investment allowance or accelerated write-offs, have historically been provided to temporarily stimulate certain economic or socially responsible capital investment activity[34], and is currently proposed for small business taxpayers[35].

[32] We note the 2015-16 Federal Budget proposal to enable small business companies that will pay tax at a 28.5% rate will continue to be able to make frankable distributions with a 30% franking credit attached and recommend that the practicalities of such an approach be considered as part of any potential subsequent rate reductions
[33] Uniform capital allowance regime Division 40 of the Income Tax Assessment Act 1997
[34] For example, expenditure on carbon sink forests was immediately deductible between 2007-12
[35] 2015-16 Budget Paper No. 2, Revenue Measure – Growing Jobs and Small Business – expanding accelerate depreciation for small business

Accordingly, we submit that there are (and no doubt will continue to be) situations where the taxation system should in fact be used to overcome barriers that prevent or hinder business investing in capital assets. This would be particularly relevant to industries or sectors that are considered to be economically or socially significant in Australia, for example, infrastructure, minerals exploration, or agriculture and arguably the small business sector.

Such relief could be provided directly through accelerated depreciation deductions (e.g. statutory caps on effective lives) or additional temporary tax allowances on specific capital asset expenditure but only where there are strong economic or social grounds to do so. For example, the 2015-16 Federal Budget proposal to provide accelerated depreciation for primary producers on certain drought preparedness depreciating assets[36].

However, it must be acknowledged that the need for such relief must be considered with other possible broader tax reforms, in particular, the rate of tax applicable to the investor.

While we are broadly supportive of the current tax treatment[37] for expenditure on tangible capital assets, we submit that there is room for improvement, particularly when it comes to simplicity. Consideration should be given to the following options:

- accounting write off vs tax write off– consider an optional choice for taxpayers to relieve complexity by aligning tax and accounting depreciating asset registers (including aligning the base and rate)
- review the process by which the Commissioner of Taxation determines and periodically reviews effective lives in the context of assessing the efficiency and cost of such a process
- the extent to which taxpayers self-assess the effective lives of depreciating assets – are there identifiable trends concerning the type of assets and the circumstances in which depreciating assets are commonly self-assessed?
- periodic review and assessment of assets that are (or should be) subject to accelerated depreciation, and
- periodic review (or indexing) of thresholds for low-cost depreciating assets[38].

3.3.1. *Buildings and structural improvements*

It has been our experience that the current tax treatment of buildings and other structural improvements[39] are complex and potentially distortionary. This does not mean that we would support a tax system which did not provide any tax recognition for such capital expenditure. Instead, a focus should be placed on devising a much simpler regime.

Much of the current complexity surrounding the treatment of capital works deductions stems from a "patch-work" system of different rates applying to different types of investments and according to the date on which the works were originally constructed. A regime that is founded upon allowances based on the original construction cost (as opposed to actual cost) is also confusing and complex.

A suggestion to simplify the regime is to adopt an approach, at least for new buildings and new capital works, that operates in the same way as that applicable to depreciating assets. In this respect, the work previously undertaken by the Review of Business Taxation in 1999[40] would be worth reconsidering and updating in the context of Australia's current social and infrastructure framework.

3.3.2. *Intangibles*

Evidence has shown that Australia (and the world) has been shifting away from the traditional forms of tangible capital investment, such as that historically used in the agriculture, mining and manufacturing sector, to capital investment that result in the creation and use of intangible assets[41]. Such a shift is not unique to Australia, but

[36] 2015-16 Budget Paper No. 2, Revenue Measure – A new drought preparedness framework – accelerated depreciation for primary producers
[37] Division 40 of the Income Tax Assessment Act 1997
[38] Applicable in Subdivision 40-E and, for small business taxpayers, in Subdivision 328-D of the Income Tax Assessment Act 1997
[39] Division 43 of the Income Tax Assessment Act 1997
[40] See recommendations 8.12, 8.13 and 8.14 of *A Tax System Redesigned*, July 1999
[41] *Re:think Tax Discussion Paper*, 30 March 2015, p 89

a global phenomenon. The broader question is whether Australia is getting its fair share of local investment in the sort of intangible assets that result in enhanced productivity and profitability.

Our tax system needs to keep in step with such investment shifts ensuring that it is not only internationally competitive, but simple to apply while at the same time recognising how different types of intangible assets are created, used and enhanced over their life.

It is our view that Australia's higher business tax rates, slower rates of depreciation on certain forms of intangibles, complex depreciation rules, and the capital gains tax are factors that are likely to discourage various forms of intellectual property being held locally, i.e. Australian taxpayers are more likely to pay a royalty overseas for the right to use an intangible than create or acquire and hold an intangible asset in Australia.

Leaving aside the broader issue of tax rates and innovation (covered elsewhere in this submission), it is our view that it would seem appropriate that some form of tax write off should apply to the cost of certain intangibles, particularly when having regard to the international tax treatment of intangibles across many jurisdictions. Furthermore, it would seem that the rate at which those intangibles are currently eligible for tax write-off[42] is comparatively slower than many other countries. Accordingly, we challenge the basis upon which a fixed period has been set into our current tax law.

For example, the rate at which an Australian taxpayer deducts expenditure on the acquisition or development of in-house software[43] is much slower than that in many other jurisdictions and is fixed rather than based on actual effective life. It would appear to be a logical observation that the effective life of a lot of software is declining as technological advances grow exponentially.

We accept that there are valid policy reasons as to why acquired goodwill is not subject to tax write-off. However the policy basis as to why there is no tax write-off for the cost of trademarks should be reconsidered, having regard to the basis upon which many other countries provide a tax write-off for trademarks.

3.4. Losses

It is our experience that the company loss rules are overly complex and hinder genuine business restructuring, and for some, they can discourage risk-taking and innovation. Additionally, it is worth noting that it has been our experience that a value is placed on losses by prospective purchasers of companies to the extent that they are available.

Although we support the need to have integrity rules underpinning the tax system which aim to ensure that businesses do not trade in, or inappropriately duplicate, losses, these rules need to be balanced to ensure that the tax system also facilitates legitimate and efficient business restructures.

3.4.1. Reduce complexity

We submit that the current company loss rules are particularly onerous for companies to apply. The complexities of the rules include:

- difficulty in applying the continuity of ownership test (COT) and uncertain application of the same business test (SBT)
- difficulty in understanding and applying the loss integrity provisions, i.e. the unrealised loss provisions and the inter-entity loss duplication rules[44]
- the interaction of the loss rules with other areas of the tax law such as the tax consolidation regime which imposes an additional layer of integrity for access and use[45], and
- differences in the loss rules as between companies and trusts in terms of tests, treatment of net capital losses and integrity rules.

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[42] Under Division 40 of the Income Tax Assessment Act 1997
[43] Currently written off over a four-year period, but in accordance with an announcement made in the 2014-15 Mid-Year Economic Fiscal Outlook, 15 December 2014, this is to be increased to a five-year period for expenditure incurred from 1 July 2015
[44] Subdivision 165-CC and Subdivision165-CD of the Income Tax Assessment Act 1997
[45] Division 707 of the Income Tax Assessment Act 1997

The compliance burden imposed on taxpayers from navigating the loss rules is significant. It is our experience that formal tax advice is frequently obtained on the treatment of losses (particularly for the SBT) following a change in ownership or prior to a restructure, and in many cases, after applying the law to the specific facts, there often still remains an element of uncertainty as to whether the losses are in fact available.

We have experienced many instances in which the loss rules were difficult to apply in particular client circumstances or where they resulted in the failure of the loss tests (and often in spite of their actually being no change in ultimate ownership):

- automatic deemed COT failure in the context of a multiple entry consolidated group[46] without any recourse to testing the actual ownership
- difficulty in applying the rules where the loss company is owned by foreign residents including ownership interests held by a foreign discretionary trust
- loss companies in financial difficulty that attempted to refinance existing debt by issuing shares with varying rights to the original debt holder as part of a debt restructure
- global restructures of large public groups by way of share amalgamation, mergers, "spin-offs", or "top-hatting" at the ultimate foreign parent level
- difficulty in reconciling the application of the loss integrity rules (inter-entity loss multiplication and unrealised loss rules), particularly in a tax consolidated group where there is inconsistent outcomes which emerge from different business/share disposal strategies
- difficulty in applying the loss tests when determining the ongoing availability of the research and development (R&D) tax offset when a company with unused R&D tax offsets joins a consolidated group, and
- impossibility to satisfy the SBT to a tax consolidated group following acquisition or disposal of a material subsidiary member/business.

To further comment, there is also an element of uncertainty overlaying the complexity in applying the loss rules to common corporate structures which have shares on issue with unequal share rights. This has been a concern to many companies, both small and large, seeking to apply the COT since 2002, where a strict application of the law often results in a denial of the COT, even though there is no significant change in underlying beneficial ownership during the test period. An announcement[47] was made to rectify this position (with retrospective application from July 2002), but to date the law has not been enacted. It has been our experience that many companies have been relying on this unenacted proposal as they need this measure to readily access losses, but have done so without certainty.

Both the Henry Review and the Business Tax Working Group[48] acknowledged the significant complexity in the loss rules. Both reports concluded that the current loss rules can hinder restructures and growth opportunities. We submit that it is possible to reduce the complexity in the loss rules by simplifying the tests, whilst still supporting the same integrity policies of the rules.

3.4.2. *Revise the same business test*

We submit that the SBT is of greatest concern for loss companies that seek to change business practices and/or diversify into more profitable activities or adapt to changing markets and that it should be modernised. In its current form, it often discourages companies to move quickly to more profitable activity and/or adopt innovative business practices.

While it is our view that the SBT should be reviewed, it is also worth pointing out that not only is the existing SBT unduly harsh for companies, it is not available to the majority of trusts[49] seeking to deduct tax losses – the tax laws should at least operate in a consistent manner regardless of the type of entity.

[46] Section 719-280 of the Income Tax Assessment Act 1997
[47] Minister for Revenue and the Assistant Treasurer's media release (No 048), 8 May 2007, *Company loss recoupment rules*
[48] Business Tax Working Group, 2012, *Final report on the tax treatment of losses*
[49] Only a listed widely held trust is able to utilise the same business test – Subdivision 266-D Schedule 2F of the Income Tax Assessment Act 1936

The Business Tax Working Group identified that the SBT too narrowly prescribes the range of activities a company can operate following a change in ownership without forfeiting its carry forward losses[50]. This does not make sense in the modern day business environment and places companies at a disadvantage as they are restricted from diversifying their operations following a change in ownership.

We support the previous work of the Business Tax Working Group in its consideration of alternatives to reform the existing SBT so that is simpler and more efficient for companies to apply following a change in ownership and submit that work should progress to give effect to its recommendation that further analysis be undertaken to develop a model for reforming the SBT[51].

3.4.3. *Reinstate the loss carry back rules*

We recommend consideration be given to the reinstatement of the loss carry back rules that were repealed in 2014. These rules were aimed at supporting existing smaller to medium company businesses by providing them the ability to claim back a portion of tax previously paid. This flexibility allows companies the choice to either carry back or carry forward a loss during short term periods of downturn.

The Explanatory Memorandum to the Bill[52] that enacted the loss carry back rules set out the benefits of the measure including:

- Firms that have recourse to loss carry-back can benefit from the improved cash flow that results from more timely and certain access to tax losses
- The measure reduces the tax system’s bias against sensible risk taking and thereby supports investment in innovation and adapting to changing economic circumstances, and
- Carrying losses back flattens taxable income peaks and troughs. Consequently, this can help the economy in a downturn and allow for faster recovery of government revenue when the economy rebounds[53].

The measure would bring Australia in line with other developed international tax systems which have a loss carry back regime, including the United States, the United Kingdom, Canada, France, Singapore and Germany.

For those who conduct business in an unincorporated form, consideration should also be given to allow a loss carry back regime to maintain equity for those individuals operating as sole traders, but this would also need to be weighed up against any potential additional compliance burden.

3.4.4. *Incentives for start-up business?*

Whilst a loss carry back regime provides benefits for existing companies, the tax system does not reward the behaviour of start-up companies which engage in new and riskier investments. Gaining capital investment can be difficult for projects that have higher risk where there is no guarantee of any return on the activities. These companies may incur tax losses in the early start-up phase, which are of little immediate benefit to investors. Start-up companies only have the ability to carry forward tax losses to offset against future taxable earnings, but are faced with the overly complex COT and SBT rules to utilise the losses in future years. This may act as a disincentive for these companies to seek additional capital from new investors or diversify their operations.

The recently enacted temporary Exploration Development Incentive (EDI) available to minerals exploration companies is a targeted mechanism which enables the conversion of income tax losses arising from exploration expenditure into a refundable tax credit that can be passed on to shareholders, subject to integrity measures[54]. While the current EDI has some merits, its practical application in the form in which it is provided is not without complexity. Furthermore, it is unknown at this stage whether its existence has in fact assisted any companies in raising capital for exploration activities.

Where there are strong economic grounds to drive new investment in risky, innovative ventures, there may be merit in having some form of targeted measure to encourage or stimulate investment in start-up companies so that new discoveries, technologies and innovations are made in Australia. Possible changes to the tax treatment

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50 Business Tax Working Group, 2012, *Final report on the tax treatment of losses*, p41
51 Business Tax Working Group, 2012, *Final report on the tax treatment of losses*, p ix
52 Tax and Superannuation Laws Amendment (2013 Measures No 1) Bill 2013
53 Regulation Impact stated in the Explanatory Memorandum to Tax and Superannuation Laws Amendment (2013 Measures No 1) Bill 2013, p 8
54 Division 418 of the Income Tax Assessment Act 1997

of start-up losses may be an option that could be considered (see also our comments at section 3.9 in this submission). Any decision to do so would need to firstly have regard to broader tax reform outcomes and the implications of such a base narrowing measure that may potentially create distortions in investment behaviour.

3.5. Multinationals

It is recognised that globalisation has profoundly impacted how multinational corporations (MNCs) are organised and the way they conduct business[55]. The growing integration between national economies and markets has contributed towards the increasing flow of capital and investments between countries[56], and as corporations seek to be competitive in an international market, it follows that investments are likely to be made where profitability is the highest. As tax is one of the factors of profitability for a corporation, it is evident that the tax system of a country will affect the decisions of MNCs on where and how to invest[57].

While there are numerous factors that influence an MNC's decision on where and how to invest, on the basis that a country's tax system is likely to have an impact on an MNC's investment decision, it theoretically follows that an optimal tax system should be designed to minimise tax distortions to improve the economic efficiency of the national and global economy[58].

It is clear that the following benchmarks against which international tax regimes are assessed[59] raise competing priorities and currently, there is no consensus between tax analysts on the proper balance between these principles[60]:

- Capital export neutrality, which seeks to achieve neutrality in international investment decisions by neither encouraging nor discouraging capital outflows. This will be achieved where pre-tax rates of return on investments are equal regardless of the source of income.
- Capital import neutrality, which seeks to achieve neutrality in international savings decisions, with the after-tax rate of return on an investment in any particular country the same for all investors regardless of their residence. This would be achieved where MNCs are able to compete in foreign markets without bearing a higher effective tax burden than a domestic company operating in the source country.
- National neutrality, which seeks to match the pre-tax return on domestic investment with the post-foreign tax return on foreign investments.

When examining Australia's current tax system, it is evident that the neutrality benchmarks are reflected to some extent in the provisions relating to the taxation of foreign income of residents (taxation of outbound investment) and the taxation of non-residents on Australian source income (taxation of inbound investment).

In the context of reforming Australia's tax system, these neutrality benchmarks should continue to inform the design of Australia's international tax regime within the broader context of Australia's position as a small open economy[61], and net international investment liability position[62]. In addition, this needs to be balanced with policy objectives such as protecting Australia's tax base, minimising compliance costs and legislative complexity, promoting international competitiveness, and the interaction with and effects of other countries' tax policies.

It is worth noting at this point that Australia's 2015-16 Federal Budget proposal[63] to tax certain foreign entities as if the foreign entity had supplied goods or services to Australian customers from an Australian permanent establishment is an unwelcome departure from the general principle that Australia will not tax the profits of foreign companies doing business with Australian customers, unless those companies actually have a permanent establishment in Australia. While we are not challenging or disputing the need for Australia to be

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[55] For instance, see OECD, 12 February 2013, *Addressing Base Erosion and Profit Shifting* Chp 3; *Australia's Future Tax System report to Treasurer*, December 2009, Chp 5
[56] OECD, 12 February 2013, *Addressing Base Erosion and Profit Shifting* Chp 3
[57] Ibid
[58] Australian Treasury, August 2002, *Review of International Taxation Arrangements,* Consultation Paper, p 91
[59] Australian Treasury, August 2002, *Review of International Taxation Arrangements,* Consultation Paper, p 8
[60] Arnold, B and Mcintyre, M, *International Tax Primer*, 2nd Edition, p 6
[61] For instance, see Australian Treasury, August 2002, *Review of International Taxation Arrangements, Consultation Paper*, p 11 and *Australia's Future Tax System report to Treasurer*, December 2009, p 8
[62] Based on ABS Catalogue 5352.0, Australia's net international investment liability position as at 31 December 2014 was $866.1 billion
[63] 2015-16 Budget Paper No. 2, Revenue Measure – Combatting multinational tax avoidance – a targeted anti-avoidance law

able to tax what is fairly attributable to Australian operations, the unilateral approach taken is not ideal in the context of the global tax environment and having regard to the broader OECD base erosion and profit shifting (BEPS) Action Plan (see further at section 3.5.1 below).

There has been considerable reform to the treatment of foreign income and taxation of foreign residents over the past 15 years which, in our view, has gone a long way to removing potential distortions or inefficiency. At the same time, it is our view that Australia's controlled foreign company (CFC) regime is amongst the most complex in the world, together with Australia's tough transfer pricing and thin capitalisation rules. We consider that there can be room to improve the CFC and thin capitalisation rules in the interests of removing complexity and/or providing greater certainty[64] – but this needs to be considered in view of the OECD BEPS Action 3: Strengthen CFC Rules and Action 4: Limit Base Erosion via Interest Deductions and Other Financial Payments.

In respect of the taxation of inbound investment, we support the reforms in the financial services sector undertaken in response to the Report of the Australian Financial Centre Forum *Australia as a financial centre: Building on our strengths*. However, there remains further work to be done to deliver on the key tax recommendations in that report including reforms to the treatment of collective investment vehicles (which has been the subject of a Board of Taxation review[65] that has not yet been publically released). Delays in responding to other reforms from the report, including, for example, the implementation of the final element of the Investment Manager Regime[66], has been an ongoing source of frustration for the industry, and undermines the ultimate goal of positioning Australia as a financial centre in the Asia Pacific region. In addition, we would recommend revisiting the policy basis upon which some of the recommendations made as part of the *Australia as a financial centre* report have subsequently been dropped[67].

3.5.1. *Interaction with international laws*

Issues associated with the development of any new law or reform in this area is inherently complex not just from a domestic perspective and having regard to the overall reform of the Australian tax system, but also with the overlay of the current international tax landscape.

A prime example of the influence of the international tax landscape and its impact on the reform of Australia's tax system is the issue of BEPS. It is clear that Australia's tax policy and system cannot be designed in isolation as it is often the interaction of principles and the tax rules of different countries that create opportunities for BEPS[68]. As such, we strongly support the efforts of the OECD and the G2o with the BEPS 15-point action plan and their efforts in working towards a unified movement of tax reform to ensure that global tax rules remain current with business evolution.

We believe effective reform of the global tax system will only be achieved if all (or a large majority) of the key global economies participate in a cooperative, coordinated and consistent way. While some governments are using the BEPS project to advance their domestic tax agendas and to claim their 'fair share' of corporate tax revenues by taking unilateral actions in advance of the project's completion, the risk inherent in this trend is that as soon as one country moves ahead of the OECD consensus process, others are spurred to action, not wanting to be left behind. We caution against such an approach as we consider that a unilateral approach by particular governments and tax administrations to modernise the global tax rules is unlikely to be effective and may have negative consequences.

International tax treaties will always remain important when assessing the appropriate outcomes for the treatment of both inbound and outbound investment and earnings activity. In this respect, we continue to support and encourage the adoption of a framework upon which Australia's tax treaties are periodically

[64] For example, along the lines of the Board of Taxation's current review into the thin capitalisation arm's length debt test
[65] Board of Taxation, *Review of Tax Arrangements Applying to Collective Investment Vehicles*, http://www.taxboard.govau/content/content.aspx?doc=reviews_and_consultations/collective_investment_vehicles/default.htm&pageid=007
[66] Only introduced into Parliament as Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015 on 27 May 2015
[67] For example, Recommendation 3.4: Withholding tax on interest paid on foreign raised funding by Australian banks; on interest paid to foreign banks by Australian branches; and on financial institutions' related party borrowing
[68] OECD, 12 February 2013, *Addressing Base Erosion and Profit Shifting* Chp 3

reviewed for current context and that there is a systematic process for considering the priority for entering into new tax treaties having regard to Australia's major investment countries[69].

3.5.2. ***Transfer pricing***

Before commenting on the appropriateness of Australia's transfer pricing law, it is important to note that as a commercial matter, MNCs need to determine the allocation of global profits between group members as a method of measuring performance. In order to determine its global profit allocation, a MNC is required to determine the transfer price at which goods and services should pass between group members internally[70]. While it is recognised that a MNC has large discretion in the way in which it organises and conducts its business, the determination of a transfer price, in and of itself, should not be viewed as a tax avoidance practice.

As stated above, it is acknowledged that the increasing interaction of principles and tax rules of different countries may create incentives and opportunities for BEPS and the discretion of a MNC to set its transfer price may provide an opportunity to allocate global profits to group members in a way that does not accurately reflect the economic contribution of the member. Accordingly, we support the need for transfer pricing measures to address the potential mismatch between profit allocation and the distribution of risks, assets and functions across the group and we are encouraged by the recent changes to closer align Australia's transfer pricing rules with the OECD Transfer Pricing Guidelines.

PwC has represented numerous clients in dealing with their transfer pricing compliance obligations, including tax return disclosures (International Dealings Schedule (IDS)) and preparation of transfer pricing documentation, and in dealing with the revenue authorities (particularly in Australia) including Transfer Pricing Record Reviews (TPRRs), Client Risk Reviews (CRRs) encompassing transfer pricing issues, transfer pricing audits, Advance Pricing Arrangements (APAs), and Mutual Agreement Procedures (MAPs). It has been our experience that there is a significant compliance burden placed on MNCs, both large and small, in complying with the law and particularly in dealing with the revenue authorities.

In order to address any concerns that our transfer pricing rules impose an excessive regulatory burden on MNCs and potentially discourage investment into Australia, we believe it is crucial to:

- ensure that the transfer pricing rules are clear, simple to comply with and consistently applied
- streamline the administration of the transfer pricing measures and the interactions between tax administrators and taxpayers, and
- apply the transfer pricing measures in a manner which is consistent with international best practice.

Firstly, we acknowledge and support the work of the ATO in seeking to address some of the compliance burden concerns which were recently raised by the Inspector General of Taxation's *Review into the Australian Taxation Office's management of transfer pricing matters*[71] including recommendations which are aimed at reducing the compliance burden for small to medium enterprises, including the increased use of safe harbours for lower value and more common transactions.

The ATO has taken a step in the right direction in providing safe harbour guidance for small taxpayers and low-value transactions[72] , but in our view this guidance does not go far enough. The measures offered by the Commissioner are so narrow in scope, and the eligibility criteria so strict, that many taxpayers will be excluded even though they may engage in low risk or low value transactions that are within the spirit of the measures. Furthermore, the measures do not provide real certainty to taxpayers because they are only a temporary non-binding undertaking that the Commissioner will not allocate resources to conduct compliance activity. Lower compliance costs and greater certainty for taxpayers could be achieved by ensuring safe harbours are binding

[69] Refer to Recommendations 3.7 and 3.8 of the Board of Taxation's *Review of International Taxation Arrangements, Report to Treasurer*, Volume 1 , 28 February 2003
[70] OECD, 2012, "Introduction", in *Dealing Effectively with the Challenges of Transfer Pricing,* p 14, http://dx.doi.org/10.1787/9789264169463-5-en
[71] Inspector-General of Taxation, December 2013, *Review into the Australian Taxation Office's management of transfer pricing matters A report to the Assistant Treasurer*
[72] Australian Taxation Office, December 2014, *Simplifying transfer pricing record keeping*, https://www.ato.gov.au/Business/International-tax-for-businesses/In-detail/Transfer-pricing/Simplifying-transfer-pricing-record-keeping/

on the Commissioner of Taxation (by enabling them to be issued by regulation) and ensuring the scope of matters capable of being brought under a safe harbour is as wide as practical.

We also acknowledge that the ATO is currently consulting on opportunities to provide further safe harbours and we support the actions taken to continuously identify and achieve red tape reductions in transfer pricing[73].

In order to provide certainty to taxpayers on more complex transfer pricing matters, we suggest that the administrative processes applicable to Private Binding Rulings be extended to Advanced Pricing Arrangements (APA), including setting time frames by which the Commissioner must finalise an APA. This would be consistent with the approach adopted for rulings as well as provide commercial certainty for taxpayers in their dealings with the ATO.

In relation to the prospect of fundamental transfer pricing law changes, we are of the view that there should be no changes to the transfer pricing law in Australia that are unilateral or which anticipate the completion of the OECD BEPS project.

In this regard, it is worth noting that our transfer pricing rules have just been updated and rewritten so they are already consistent with the current OECD approaches (except in relation to attribution of profits to permanent establishments). Any changes should only be made in line with the OECD's recommendations and should be implemented in a manner that does not result in duplication of time and resources by affected MNCs in the context of the existing Australian law. For example, this year's Federal Budget announcement[74] to adopt the OECD's new transfer pricing documentation package including Country-by-Country (CbC) reporting from 1 January 2016 is consistent with the OECD's proposals, but care will need to be taken in the implementation process to ensure the new requirements are harmonised with existing local transfer pricing documentation requirements rather than becoming an additional compliance burden on top of the existing obligations.

3.6. Revenue/capital distinction

The current law is premised on different treatment for capital gains/losses and revenue gains/losses by virtue of the fact that:

- capital losses can only be offset against capital gains – a form of quarantining – but tax losses can be applied against net capital gains, and
- discounts or concessions apply to capital gains, but not to revenue gains.

So long as those differences exist in our tax law, ascertaining the capital or revenue character of a transaction will be an issue that needs to be addressed by all taxpayers.

We acknowledge there is complexity in the tax system in determining whether income is earned on revenue or capital account. The difficulty of the distinction arises from the necessity of applying the general tax law according to the individual taxpayer's facts and circumstances. There is no bright line test (as is often found in other jurisdictions) to indicate whether an amount is earned on revenue or capital account and it has been our experience that the uncertainty which can exist in some situations has made Australia a less attractive place to invest.

Complexity also arises where the characterisation of an asset or payment can switch between revenue and capital account. For example, an item originally held on capital account may undergo a change of use or purpose such that it may become trading stock or simply commence to be held on revenue account. The law is not always clear in such cases and in many cases, it has been our experience that it often results in lengthy and costly dispute with the revenue authorities, or can lead to restructuring the ownership of the investment so as to make clear the distinction by reference to different legal owners. This necessitates undue compliance burdens.

In considering a solution to remove some of the complexity, we note that there is precedence in the existing tax law which aims to promote certainty on the revenue/capital distinction for some specific situations. For example:

[73] Australian Taxation Office, 30 April 2015, *Matters under consultation – Technical: [201511] Safe harbours – Transfer Pricing*, https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/Matters-under-consultation/Technical/#BK_20155Internationaldealings

[74] 2015-16 Budget Paper No. 2, Revenue Measure – Combatting multinational tax avoidance – new transfer pricing documentation standards

- The taxation of financial arrangement (TOFA) rules[75] aim to reduce complexity by effectively removing the revenue/capital distinction for most financial arrangements by treating the gains and losses on revenue account, except in very limited circumstances[76]. While the TOFA rules themselves are complex, it has been our experience that the removal of the revenue/capital distinction has provided certainty and simplicity by providing a bright line test for the treatment of gains and losses for financial arrangements.
- Australian managed investment trusts (MITs) can make an irrevocable election to treat gains and losses on the disposal of certain assets on capital account for tax purposes, subject to appropriate integrity rules[77]. This choice has removed the uncertainty of applying the general tax law for a MIT, ensuring that their individual gains and losses will be treated on capital account. In our experience, the election is both efficient and provides clarity in the law for a significant number of MITs, enabling them certainty in accessing capital gains concessions.

Short of having the same treatment apply to gains or losses whether on revenue or capital account (which no doubt will lead to significant transitional issues and substantial cost to the revenue), there may be merit in considering whether there can be some form of bright line test (or taxpayer election) to distinguish a transaction as being on revenue or capital account in the interests of promoting certainty and reducing complexity and undue compliance burdens.

In relation to the capital and revenue distinction for items of expenditure, we have a breadth of judicial precedent that has established core principles, but often this is not always easy to apply and accordingly leaves room for uncertainty, error and complexity for some taxpayers. Recent examples which have highlighted complexity and potentially differing treatments by taxpayers include the treatment of labour costs associated with the construction of depreciating assets[78] and the maintenance and development of websites[79] or other forms of intellectual property. Short of adopting a regime which relied on the accounting treatment as the determining factor, perhaps such difficult interpretative issues can be addressed by having a set of clear guidelines to assist in forming a conclusive outcome acceptable to both the taxpayer and revenue authority.

3.6.1. *Business related costs*

The introduction of the "business related costs" provision[80] has removed the inequity for a lot of capital expenditure that would otherwise fail to be recognised in the tax system by providing a write-off over five years. However, we support the comments made by the Business Tax Working Group[81] that a five-year write-off is quite arbitrary and may not be warranted, particularly in the case of expenditure relating to business creation[82], restructure or cessation.

There also may be scope to improve the current operation of the provision by extending its application to non-business scenarios and to clarify the existing confusion concerning the exceptions as applicable to 'leases or other legal or equitable rights'. Whilst the ATO has attempted to provide clarity via a public ruling[83], this issue would be best resolved by legislative amendment.

3.7. *Specific measures for certain types of businesses*

3.7.1. *Insurance*

Our income tax law currently provides specific tax provisions which deal with general and life insurance companies.

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[75] Division 230 of the Income Tax Assessment Act 1997
[76] Explanatory Memorandum to Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009, para 3.21-3.23
[77] Subdivision 275-B of the Income Tax Assessment Act 1997
[78] See ATO ID 2011/42, ATO ID 2011/43 and ATO ID 2011/44, released 12 May 2011 following a lengthy consultation process that commenced with the issue of an ATO discussion paper in July 2008
[79]See Australian Taxation Office, 30 April 2015, *Matters under consultation – Administration: [201484] ATO guidance on tax treatment of website expenditure*, https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/Matters-under-consultation/Administration/#ATO201484
[80] Section 40-880 of the Income Tax Assessment Act 1997
[81] Business Tax Working Group, 2012, *Final report on the tax treatment of losses*, p 4
[82] We acknowledge and support the current proposal in 2015-16 Budget Paper No. 2, Revenue Measure – Growing Jobs and Small Business – allow immediate deductibility for professional expenses
[83] See TR 2011/6 Income tax: business related capital expenditure – section 40-880 of the Income Tax Assessment Act 1997 core issues, paragraphs 47 and 223 - 244

For general insurance companies, these provisions effectively codify industry practice and ATO guidance[84] regarding the treatment of premiums and claims. As the tax treatments have been developed over many years and in many instances subject to industry consultation, the treatments are generally well accepted. In most respects, the tax treatment of insurance premiums and claims is aligned with the accounting treatment which therefore aids in the simplicity in the calculation of taxable income.

For life insurance companies, there were substantial changes to the tax law as part of the Ralph *Review of Business Taxation* in 1999. Under these reforms, the various businesses of a life insurance company (being risk business, investment business and complying superannuation business) were to be taxed similarly to comparable activities of general insurers, investment entities and pooled superannuation trusts. The objective was to ensure competitive neutrality and consistency with entities with similar businesses. At the time, due to the fundamental nature of the changes, significant complexity was caused by a number of factors including systems changes, the requirement to segregate assets into different tax pools and reliance on actuarial concepts. However, given the provisions have been in place for many years, the tax treatments are now generally well settled.

The specific taxing provisions for insurance companies are appropriate given the specific nature of these entities compared with other corporate entities. However, the recognition of the uniqueness of these entities (to ensure fairness within the tax system) inevitably drives complexity, particularly, where these special provisions interact with other areas of tax law (e.g. tax consolidation, CFC rules etc). Accordingly, there may be merit in considering ways to reduce the complexity.

3.8. Research and development

The research and development (R&D) Tax Incentive Program should continue to be the Government's key lever for supporting investment in Australian R&D and innovation. As PwC has outlined in a number of Parliamentary submissions over recent years, the program plays a crucial role in encouraging companies to conceptualise and undertake innovative new activities and projects that they would not otherwise do, and to conduct these activities in Australia.

Importantly, the volume based R&D Tax Incentive Program is non-discriminatory in that it is shaped by the market by encouraging and supporting investment across all sectors of the economy and across companies of all different sizes. Benefits from the program are based on actual eligible activities undertaken creating spillovers in the economy as opposed to a discretionary grants system where grants are generally awarded, in advance, to a more narrow range of companies and/or to projects that may ultimately prove unsuccessful. Given that it is an ongoing annual program, it also provides a critical level of certainty across income years, particularly for companies in the start-up phases.

Our view is premised on, and informed by, extensive and practical day-to-day experience with the operation of the current program and its forerunner, the R&D Tax Concession, for more than 20 years.

During our long association with the program, we have advised thousands of clients on their R&D activities and claims – and have therefore been presented with continuous first-hand evidence of the clear benefits of the program across a vast diversity of companies, sectors and locations.

This includes consistent and repeated evidence that new activities and projects would not have been pursued (or, at the very least, pursued to the same level) without the availability of such an incentive. Crucially the extra assistance and encouragement provided by the program also increases the depth and quality of the projects that are pursued.

It is also not simply a question of whether the R&D Tax Incentive encourages companies to conduct R&D activities that would otherwise not be conducted in the absence of government support. It is just as critical to consider whether some companies would actually invest in R&D activity in Australia, as opposed to another jurisdiction, in the absence of such an incentive.

The R&D Tax Incentive Program is one of the key triggers in attracting and retaining investment in innovation (and associated infrastructure and personnel). In part, it ensures that R&D is conducted, and continues to be conducted, in Australia ahead of other jurisdictions. Companies closely weigh up the alternative costs of performing their R&D in different parts of the world (and seek our advice on this point regularly) and, in the

[84] Income Tax Ruling IT 2663

absence of this incentive, Australia's appeal as a location for undertaking R&D activity significantly deteriorates[85].

Our own first-hand experience of companies' investment behaviour in relation to R&D is also complemented by a wide diversity of academic studies about the effectiveness and impact of R&D support mechanisms.

Such studies consistently point to a correlation between the existence of well-designed public R&D incentives and a motivation for firms to increase their R&D intensity.

Reinforcing many similar findings over the course of the past 40 years, recent studies by Mulkay and Mairesse[86] and Lokshin and Mohnen[87] for example, specifically highlight the positive impact on input additionality of public R&D incentive programs. Similarly, Czarnitzki, Hanel and Rosa[88] provide recent confirmation of many previous studies of their effectiveness at the firm level in increasing the probability of the development of new products and processes.

PwC would be happy to provide information on a number of similar studies that underscore the point that the additional R&D spending that is induced by these programs consistently exceeds the cost in foregone tax revenue.

It should also be noted that Australian governments have themselves released numerous case studies and testimonials that have specifically highlighted and lauded the role of R&D tax incentives in the growth of many local companies and shown how integral these incentives are for undertaking R&D in Australia.

AusIndustry's quarterly information bulletins and the business.gov.au website have shown dozens of examples of companies whose access to the R&D Tax Incentive has been intrinsic to their success[89].

We would also stress that the R&D program has been the subject of a succession of reviews (and reductions) over recent years. It should not again be the subject of major overhaul (and further cutting) until the full impact of these changes has been understood.

It is highly likely that the effect of changes such as the introduction of the newly-created $100 million expenditure cap[90] will be to produce a corresponding decline in the rate of growth in business expenditure on R&D in Australia. It will particularly impact companies undertaking marginal and highly risky R&D projects.

The Government's recent proposal[91] to lower the offset rates offered through the program should not be pursued for the same reason.

Actions to impose new limits on the size of investment that will attract support, to lower rates and/or to bar access to the program to certain groups of companies send a negative message to potential R&D investors. They can also create uncertainty that the support the program provides will not be maintained.

In short, such decisions compromise the attractiveness and reputation of Australia as a country in which to perform either new or further R&D. They also not only reduce the effectiveness of the existing program, but actually create a genuine disincentive for R&D investment and make Australia more of a 'fast follower' in the field of R&D rather than a 'frontier setter'.

An example of the impact of unexpected and sustained cuts to the R&D tax incentives in Australia (and the direct link between the level of the incentives and domestic R&D intensity) is provided by the experience in the

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[85] Upon request, we would be happy to confidentially provide the names of some companies, the details of their R&D activities, and the reasons that these activities would not have been conducted in Australia (and/or undertaken in another country) without the assistance they have received though R&D tax support

[86] Mulkay, B. and Mairesse, J. 2003, *The Effect of the R&D Tax Credit in France*, EEA-ESEM Conference, Stockholm <Retrieved from: www.eea.esem.com/eeaesem/2003/prog/viewpaper.asp?pid=2250>

[87] Lokshin, B. and Mohnen, P. 2012, *How Effective Are Level-Based R&D Tax Credits? Evidence from the Netherlands*, *Applied Economics* 44 (12), pp 1527-1538

[88] Czarnitzki, D., Hanel, P. and Rosa, J. 2011, *Evaluating the Impact of R&D Tax Credits on Innovation: A Microeconometric Study on Canadian Firms*, Research Policy (40), pp 217-229

[89] A selection of these case studies is accessible online, chiefly from the 'Customer Stories' page, http://www.business.gov.au/grants-and-assistance/innovation-rd/RD-TaxIncentive/Program-Information/Pages/CustomerStories.aspx

[90] Enacted by Tax Laws Amendment (Research and Development) Act 2015

[91] Tax and Superannuation Laws Amendment (2015 Measures No 3) Bill 2015

months and years following the 1996 Budget. Before the Howard Government ultimately changed course in subsequent years and re-injected substantial funding into the area of innovation, a significant drop-off in local R&D investment occurred almost immediately in the wake of those changes and, just as tellingly, persisted up until the time at which the funding was restored.

3.8.1. *Global experience of R&D incentives*

More broadly, global evidence that R&D programs are a successful lever for encouraging R&D investment is also very strong. R&D investment is highly-mobile internationally and, insofar as its complexion and location is influenced by government support, then it will typically be moved to those jurisdictions where such support is not only (more) generous but also where there is genuine long-term certainty and confidence that the arrangements underpinning it will not continue to be changed on a repeated basis.

Competition for the global innovation dollar is arguably as intense as it has been at any time in history. Accordingly, many countries are making concerted efforts to lure this investment and the rate of growth in some of these nations has proved phenomenal.

In China alone, R&D spending by the largest companies headquartered there during 2014 increased by 45.9 per cent. This was after a separate rise of 34.4 per cent during the previous year[92].

R&D tax incentive programs are now in operation in many countries across the world, including in numerous jurisdictions in our own region such as New Zealand, India, Singapore, Japan, Malaysia, South Korea and China. Recent analysis indicates there are currently at least 26 of 28 European Union and 27 of 34 OECD member states (and many other countries beyond them) that provide fiscal incentives for R&D[93]. Moreover, many countries have recently introduced measures to specifically increase the level of support they provide, including Belgium, Canada, the Czech Republic, France, Ireland, Japan, New Zealand and Norway.

In France's case, its government has also been particularly active in emphasising that there will be no reductions of any kind to its program for at least five years to create certainty of investment and attract R&D projects to be domiciled there[94]. This has been a successful strategy, with around 18,000 companies now participating in the program and the country also performing consistently well on a range of key innovation indicators. Foremost among these are the high level of annual expenditure on R&D (at around $52 billion); the close to 4 per cent annual growth in R&D performance; the comparatively high percentage of R&D funding that comes from business (at 54 per cent) and, instructively, the large figure of 8 per cent of R&D funding from abroad[95].

A belief in the inherent value of public R&D tax support is also shared by major international bodies such as the European Commission (EC). The EC has provided a range of public commentary on the efficacy of R&D incentives, including in late 2014 when it concluded that the available body of analysis indicated that R&D tax credits are effective in stimulating investment in R&D[96].

It also performed a detailed benchmarking study in late 2014 (across 80 incentives in 31 countries) to develop its own list of 20 best practice points in the design of R&D tax incentive programs. Instructively, the Australian program meets practically all of these principles, including its encouragement of R&D likely to generate strong spillovers beyond the immediate activities of the initiating companies themselves[97].

It is our view that the R&D Tax Incentive is the key program that delivers support to companies and enables R&D activities to be undertaken which otherwise would not have been. Both large and small companies create

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[92] B. Jaruzelski, V. Staack and B. Goehle, *Proven Paths to Innovation Success*, Strategy & Business, 77 (Winter 2014) pp 1-16, http://www.strategy-business.com/media/file/00295_The_Global_Innovation_1000_Proven_Paths_to_Innovation_Success.pdf
[93] European Commission November 2014, *A Study on R&D Tax Incentives – Final Report*, Taxation Papers Working Paper N.52, p 19, http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_52.pdf
[94] D. Ramli, *France offers stable R&D incentives*, Australian Financial Review, 12 March 2013
[95] National Science Foundation (USA) 2014, *Science and Engineering Indicators 2014*, pp 4-17 to 4-21, http://www.nsf.gov/statistics/seind14/content/chapter-4/chapter-4.pdf
See also OECD 2013, *Main Science and Technology Indicators*, Vol 2013/1
[96] European Commission, November 2014, *A Study on R&D Tax Incentives – Final Report*, pp 5-6
[97] Ibid, pp 6-7; 21-24

spillovers into the economy when given support for R&D. As we have highlighted, these programs exist throughout the world. OECD members, EU members and nations within our own region have been among the countries that have introduced these programs as key policy initiatives to drive domiciling R&D in their local innovation ecosystems.

3.9. Changes or other taxation incentives that could promote innovation and entrepreneurship

The Australian Government has a substantial role to play in supporting innovation and entrepreneurship across the economy in policy initiatives and specifically tax incentives. As discussed above, the R&D Tax Incentive is a critical key mechanism that should be maintained to foster innovation in Australia. There are also potentially a range of other incentives and measures that could be changed or established in order to make the environment more conducive to such activity.

As has been outlined above, and in a number of major government reports and publications over recent years (including various Budget Papers and the *2015 Intergenerational Report*), this role is also becoming increasingly important in light of the major structural changes currently occurring within Australia's economy.

Furthermore, we believe that the imperative to innovate in Australia is as relevant to larger companies as it is to their smaller counterparts. Governments need to think carefully not only about how to cultivate the economic conditions and settings that best foster new business creation and small and medium enterprise (SME) business growth, but also about how to make the environment increasingly favourable for the larger companies that naturally have the greatest financial capacity to invest in local innovation.

Indeed, one of the points that is typically lost in public commentary about the innovation tax incentives that are available to larger companies is the vital role that these businesses play in generating spillovers from their investments. In the case of R&D activity in particular, many unexpected and initially-unforeseen opportunities and new streams of work often arise from projects initiated by larger organisations[98].

We believe that there may be benefits in potentially looking at changing some of the conditions of the R&D Tax Incentive Program and/or the rate of its offsets in order to directly drive some of Australia's economic policy priorities. Below we suggest changes or reforms that might be considered when assessing ways to encourage investment in innovation or entrepreneurship.

3.9.1. Changes to the existing R&D Tax Incentive Program

In summary, we do not believe that there need to be extensive changes to the existing range of taxation incentives for innovation. This is especially true in the case of the R&D Tax Incentive, which critically needs to be maintained as a program. Insofar as changes should be made in this area, we suggest that consideration should be given revising the R&D Tax Incentive to drive specific policy objectives, such as:

- the advent of a new "super rate" to encourage increased private-public research collaboration, and
- the introduction of a regime that supports 'above the line' financial accounting for larger companies.

Australia would also be likely to benefit from the establishment of an appropriately-structured patent box regime aimed at stimulating the creation of new ideas, intellectual property and accompanying jobs.

Introduction of a higher rate to sponsor public and private R&D collaboration

Consideration might be given, for instance, to the introduction of a higher rate of offset for projects that companies collaboratively undertake with publicly-funded research institutions. Similarly, we believe that increased public-private research collaboration would be likely to be driven by relaxation of the rule that companies with more than 50 per cent tax exempt ownership cannot access the program.

Each of these changes could play a role in helping to redress the enduring problem in Australia of the relatively weak translation of publicly-funded research into commercial applications. In the process, they would likely contribute to the Government's stated objective, in its Industry Innovation and Competitiveness Agenda, of

[98] The EC 'A Study on R&D Tax Incentives – Final Report' (see pp 6, 7, 21, 22, 24 and 41) is one example among many studies that highlight that large companies create spillovers in economies when they undertake R&D

improving engagement between researchers and industry to achieve stronger coordination and collaboration of research and stronger commercial outcomes.

Supporting 'above the line' financial reporting

The potential for 'above the line' accounting treatment of the R&D benefit for all companies that access the program should be considered.

Under the current system in Australia, for SMEs the incentive is fully refundable and can be reported 'above the line' for financial reporting purposes. But, for larger companies (that is, those with greater than $20 million turnover), the credit is non-refundable and is therefore treated 'below the line'.

Design of the R&D tax incentive in a manner that would support 'above the line' financial reporting treatment in Australia would be an attractive option for larger companies and would be likely to significantly increase the additionality because options for undertaking new or increased R&D spending could be far more readily included in overall investment decisions. It is an issue that is raised on a continual basis by our clients and by other potential R&D investors, and the unavailability of such treatment undoubtedly acts as a barrier to such investment in Australia.

It has traditionally been difficult for countries administering R&D tax incentive systems to achieve such treatment in keeping with international accounting standards, but a solution recently appears to have been designed in some jurisdictions.

For example, in France, the research credit can be accounted for as 'above the line' income. This is because the French tax credit can be offset against the current overall corporate income tax liability or carried forward for a three-year period for offset. It can be refunded after this period if it has not been used.

Similar to the French system, we suggest that any R&D tax program be designed such that the incentive can be reported 'above the line' by all entities in their financial reports.

Definitional changes

In the course of replacing the R&D Tax Concession with the R&D Tax Incentive in 2011, a series of changes were made to the definitions of the types of activities that constitute eligible R&D.

Those definitions should now be revisited. We believe that they are limited and not sufficiently expansive to capture the full range of R&D activities that occur in Australia, including newer, more dynamic and more idiosyncratic forms of R&D. This is particularly true in cases of business process innovation where companies achieve improved efficiencies and increase their productivity outside of the strict scientific method of hypothesis, experiment and conclusion.

It is our view that the definitions should be expanded beyond their current scientific basis to more broadly cover the knowledge-based R&D for which Australia is becoming renowned so as not to disadvantage emerging sectors in the economy.

Introduction of a patent box regime

In light of the agreements that were reached in late 2014 over their operation in the United Kingdom and mainland Europe, we believe that the merits of potentially establishing a patent box regime should be considered. In short, the patent box model effectively seeks to reduce the rate of corporate tax paid by a company in respect of profits derived from patents developed by the company.

On the basis that any developed Australian model conforms to accepted international practice, then the establishment of a domestic patent box regime may add to the competitive tax environment for companies to develop and exploit patents and encourage the creation of high-value jobs and intellectual property.

Moreover, it should serve to arrest the moves of some Australian technology companies to reincorporate in countries where a patent box model now exists. Since the time of the inception of a patent box regime in the United Kingdom in 2013, for example, filing records have pointed to the reincorporation of a number of Australian companies in that country to access the patent box benefits.

Among the countries to have already adopted some form of patent box model are the United Kingdom, the United States of America, the Netherlands, Belgium, China, France, Hungary, Ireland, Italy, Luxembourg, Malta, Portugal, Singapore and Spain.

3.9.2. *Tax relief for individual investors in early stage companies*

There are a number of other tax incentives that can be considered to encourage innovation and entrepreneurship in Australia. This can be by way of building upon or refining the existing Early Stage Venture Capital Limited Partnership (ESVCLP) program or provide tax relief for individual investors in early stage companies along the lines of the United Kingdom Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS).

Enterprise Investment Scheme and Seed Enterprise Investment Scheme

PwC recommends that consideration be given to an EIS and SEIS regime (like that operating in the United Kingdom) that is designed to help smaller higher-risk trading companies raise finance by offering a range of tax relief to investors who purchase new shares in those companies.

The EIS operating in the United Kingdom works broadly as follows:

Eligible companies

1. Companies that will be eligible to raise money under the EIS are unlisted companies, with fewer than 250 full time employees (or equivalents) holding gross assets not exceeding £15,000,000 immediately before any share issue and £16,000,000 immediately after that issue.
2. Companies need not be resident in the United Kingdom but must have a 'permanent establishment' in the United Kingdom. Arguably any Australian EIS should not adopt this criterion, but instead adopt the existing 'Australian nexus' test that applies to 'eligible venture capital investments' for ESVCLPs[99].
3. Eligible companies may raise no more than £5,000,000 in total in any 12 month period.
4. Funds raised must be used either for the purpose of an existing qualifying trade, for the purpose of preparing to carry on such a trade or to carry out R&D intended to lead to such a qualifying trade being carried on, and must be deployed within two years of the capital raising. Excluded trades include dealing in land, certain financial activities, property development and farming. These exclusions broadly mirror the prohibited activities of companies that qualify as 'eligible venture capital investments' under the ESVCLP program[100].

Eligible securities

5. All shares must be paid up in full and in cash when they are issued.
6. Shares must be full-risk ordinary shares with no redemption or preferential rights. There must also be no arrangements in place to protect the investor from the normal risks associated with investing in shares and no arrangements at the time of investment for the shares to be sold at the end of the relevant period. This criterion broadly mirrors the existing requirement for ESVCLPs to acquire interest that are 'at risk'[101].
7. Shares must be held for three years from the date they were issued.

Tax relief

8. Income tax relief is available at 30% of the cost of the shares (up to £1,000,000), to be set against the individual investor's income tax liability for the year in which the investment was made. Income tax relief is only available to persons not 'connected' with the company.
9. Capital gains tax relief is also available on the disposal of the shares provided the investor has been eligible for income tax relief on the cost of the shares and the shares have been held for the minimum three-year period.

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[99] Section 118-425(2) of the Income Tax Assessment Act 1997
[100] Section 118-425(13) of the Income Tax Assessment Act 1997
[101] Section 118-430 of the Income Tax Assessment Act 1997

10. If the shares are disposed of at a loss, the investor can elect to deduct that loss (less any income tax relief granted) from any income in the year in which the shares were disposed of or any income of the previous year, instead of being set off against any capital gains.
11. Certain 'connected' investors may elect to defer the payment of tax on a capital gain made from the disposal of the shares in certain circumstances.

The SEIS program is similar, with lower financial thresholds and targeted at companies that are at an earlier stage of their life cycle[102].

Equity Crowdfunding

PwC welcomes the recent announcement[103] to introduce legislation facilitating access to equity crowdfunding by retail investors and we have previously made detailed submissions on the optimal structure of Australian legislation for this purpose.

The United Kingdom is arguably the world's leading alternative finance market, with equity crowdfunding volumes growing significantly between 2012 and 2014 and unlocking substantial funds for early stage companies in the United Kingdom. This traction is driven in large part by the availability of the tax relief available to investors through the EIS and SEIS programs.

The introduction of legislation to enable crowdfunding without the introduction of an Australian EIS and SEIS equivalent would leave the Australian program at a competitive disadvantage to its United Kingdom counterpart.

ESVCLPs

The ESVCLP program is an existing venture capital program designed to increase early stage capital by providing investors in ESVCLPs with generous tax concessions[104] and giving fund managers certainty that their carried interest will be on capital account.

This program has largely been a success, with all of the venture capital funds established in Australia since 2008 that we are aware of being structured as ESVCLPs. PwC has been involved in acting on the establishment of many of those funds and in our view there is little doubt based on our experience that the availability of the tax concession has worked to balance the high-risk nature of passive early stage venture capital investments and has helped Australian fund managers raise capital for the sector more effectively.

Our view is that in parallel to the ESVCLP program, there should be encouragement of *increased direct investment* into early stage companies and we recommend that consideration be given to providing similarly targeted taxation concessions. In practice, this would apply to investments by angel investors and through equity crowdfunding platforms.

An equivalent Australian EIS and SEIS program would recognise the global growth of direct individual investment into early stage companies and creates equity between passive investments made through funds structured as ESVCLPs and direct investments made by individual investors into companies that meet the same early stage criteria.

Any introduction of an Australian equivalent to these schemes should be designed to align with the existing investment parameters that apply to ESVCLPs. The current law governing ESVCLPs[105] already deal with the parameters governing matters such as the criteria for 'early stage' investing and 'eligible venture capital investments' and could readily form the basis of any Australian EIS and SEIS program.

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[102] Eligible companies must have assets of less than £200,000, fewer than 25 employees and raise no more than £150,000.
[103] Minister for Small Business, 6 May 2015, *Supporting start-ups and entrepreneurship*
[104] Distributions from ESVCLPs are broadly exempt from Australian income tax and CGT provided there is compliance with the program rules
[105] Section 118-407 of the Income Tax Assessment Act 1997

4. Small business

For the purposes of this submission, any reference to “small business” should be seen to be any business undertaken by closely held private business, i.e. where the ultimate owner, operator, manager and employee can be the same individual(s).

At the outset, we consider that any tax reforms targeted at the small / private business sector need to facilitate:

- reduced complexity
- growth, and
- a level playing field with large business to ensure private businesses remain competitive.

A lot of the complexity within the Australian tax system is caused by specific anti-avoidance measures targeted at private business[106]. Compliance with the tax laws by this sector requires the use of tax and legal advisers in addition to accounting professionals.

In our experience, small businesses face a number of impediments throughout their business lifecycle due to the impact the tax laws have on their operating structure. Some examples are included below.

Example 1: Implementation of succession plans ‘pre-death’

- For a small business, the inter-generational transfer of the ownership of business assets is typically a once-in a lifetime decision. One hurdle to the implementation of an orderly succession plan for private companies is the CGT and other transfer taxes that may arise upon the transfer, redemption and / or issue of shares held in the family company.
- Tax concessions are available upon the death of an individual which might reduce these costs, but for most private groups it is too late to wait until the death of a key individual to implement an effective succession plan (especially in the current economic environment).
- We consider that in order to enable the private sector to take a more active and competitive approach to the management of their business, private companies should be given a degree of flexibility to issue, redeem and transfer shares within their family group. Only if non-family group members become involved should any tax implications arise, and in this context, for example, there may be merit in having a 'Family Company Election' (similar in concept to the Family Trust Election) to record who falls within the family group.
- It was announced in the 2015-16 Federal Budget that tax relief by way of a CGT roll-over would be provided for small businesses that change their legal structure[107]. But as it is only intended to apply to small businesses with an aggregated turnover of less than $2 million many private companies may not be able to access it, nor may it assist when families want to pass ownership of assets on to the next generation.

Example 2: Business start-up and exit – incorrect application of small business CGT concessions

- It is not uncommon for us to encounter new clients who previously have been incorrectly advised as to the application of the small business CGT concessions – on both the initial set up of their business structure and on its eventual sale. This in itself highlights the current complexity, even for advisers, in understanding the relevant law.
- A typical example involves a business which is operated through a corporate structure, and the commercial decision has been made to sell the underlying business assets as opposed to the shares in the company which are held directly by the individual.
- When setting up their initial structure, the client has been previously advised that the small business CGT concessions should apply to them regardless of whether they operate as a sole proprietor, or through a discretionary trust or corporate structure. A corporate structure is eventually chosen due to the limited liability protection it affords.

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[106] For example, the deemed dividend rules applicable to private companies, Division 7A of the Income Tax Assessment Act 1936

[107] 2015-16 Budget Paper No. 2, Revenue Measure – Growing Jobs and Small Business – capital gains tax roll-over relief for changes to entity structure

- Unfortunately, it is often not brought to the client's attention that where the small business 50% reduction[108] is applied by a company, any subsequent distribution from the company to the shareholder are not tax free[109]. That is, any distribution of the after-tax gain from the sale of the company's business to the shareholder would be treated as a partially franked dividend. This can potentially result in an overall effective tax rate of 47% [110] applying to the entire capital gain.
- A very different after-tax result would be achieved if:
(a) the client had sold the shares in the company as opposed to the underlying business assets; or
(b) the business was operated through a discretionary trust structure (of which the client was a potential beneficiary) or as a sole proprietor,
as the individual would directly receive the benefit of the small business 50% reduction in their own right[111]. In both of those scenarios, the overall effective tax rate on the capital gain would have been 23.5% (or 11.75% if the general 50% CGT discount was also available[112]).
- The small business 50% reduction concession clearly applies less favourably where a corporate structure has been utilised. As company structures provide important limited liability advantages, the operation of the concessions in this scenario is at odds with commercial intent and inequity due to the differential tax outcomes.
- In this context we note and support the Draft Recommendation of the Australian Government Productivity Commission that there should be a consistent approach to the taxation of business entities regardless of their ownership structure and size[113] .

Example 3: Utilisation of private company funds – Strict Division 7A requirements

- The deemed dividend rules (in Division 7A of the *Income Tax Assessment Act 1936*) operate to penalise owners who, amongst other things, obtain loans from private company with terms, whilst often commercial, do not comply with other strict requirements of the Division – including regular repayment within seven years[114].
- In many cases private companies are forced to pay out dividends to enable loan recipients to meet their repayment requirements, thereby depleting the level of funds available to meet working capital requirements.
- Alternatively, owners are forced to borrow from third parties as they usually offer less onerous debt servicing demands. This leads to additional costs being borne by family groups and inefficient capital markets.
- Public companies are not subject to the restraints imposed by Division 7A. Private companies should therefore not be placed at a competitive disadvantage by the operation of these rules if there is an ability to utilise funds from within the private group environment.

4.1. Small business structures

The tax system has some bearing on choice of business structure for small businesses.

The majority of small businesses are advised by long serving accountants who may not be tax experts. An accountant's advice is usually focused on important factors such as:

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108 See Subdivision 152-C of the Income Tax Assessment Act 1997
109 This is in contrast to the treatment where a company disposes of assets and is able to apply the 15-year exemption (see section 152-125 of the Income Tax Assessment Act 1997) or the small business retirement exemption (see 152-310 of the Income Tax Assessment Act 1997)
110 Assume that of a $1 million capital gain, the corporate entity pays tax at 30% on 50% of the capital gain (i.e. $150,000). The after-tax gain of $850,000 is distributed to the individual shareholder as a partially franked dividend. Assuming a top marginal tax rate of 47% (including Medicare levy), the individual shareholder would incur an additional tax liability of $320,000. Total tax paid on the $1 million capital gain is therefore $470,000 (i.e. 47%).
111 Note that the CGT legislation provides "flow-through' treatment for a presently entitled beneficiary, where the trust qualifies for the small business 50% reduction (see section 115-215 of the Income Tax Assessment Act 1997)
112 See Subdivision 115-A of the Income Tax Assessment Act 1997 for the application of the 50% CGT discount. This discount does not apply to gains derived by companies.
113 See Draft Recommendation 4.1 of the Australian Government Productivity Commission's Draft Report, *Business Set-up, Transfer and Closure*, May 2015
114 See section 109N of the Income Tax Assessment Act 1936

- liability protection
- ease of doing business, and
- succession planning.

Their income tax advice is usually limited to the effective rate of tax on future profits of the business operations.

Many taxpayers do not seek detailed structuring advice at the time of commencing an enterprise either in the belief their existing adviser is adequately qualified to advise on such tax matters or because the costs associated with obtaining this advice is prohibitive. Although it is acknowledged that the 2015-16 Federal Budget measure[115] to allow businesses to immediately deduct a range of professional expenses associated with starting a new business, such as professional, legal and accounting advice may alleviate some of these cost pressures.

In many cases, small business later becomes aware that various concessions within the income tax system (e.g. small business CGT concessions) are simply not available due to the structure they have employed. (See Example 2 above for further details.)

4.1.1. *Alternative business structures*

Other options, such as flow-through entities (like an S-Corporation), could reduce the overall complexity and costs for small business. Such an approach may render many of the overly complex specific anti-avoidance provisions[116] redundant.

However, any change to the taxation of small business would need to be done having regard to other tax reform changes to the individual rates of income tax. Otherwise small business is likely to be placed at a disadvantage to large business that typically uses a company structure. This is because large businesses operating through a company have a rate of tax not exceeding 30% (currently), whilst small business could have a significantly higher effective rate of tax.

It should be noted that in comparison to the Australian income tax regime, the United States has a Federal corporate rate of income tax of 35% and a top individual marginal tax rate of 39.6%[117]. The latter being imposed only on individual incomes that exceed USD413,201[118] (although we acknowledge that individual States in the United States charge income taxes). Consequently, the differential between the corporate tax rate and top marginal tax rate in the United States is not as great as what we currently have in Australia.

Accordingly we would recommend that consideration of any flow through approach should also incorporate:

- reductions in individual marginal rates of income tax so that it is more in line with the corporate tax rate
- access to concessions (e.g. small business CGT, discount capital gains and R&D concessions) currently afforded to other structures (e.g. sole traders, certain trusts and partnerships), and
- flexibility to distribute profits of the flow-through entity to family members.

4.2. The interaction between the personal and business tax system

The interaction of the personal and business tax systems is a problem. The differential between the higher individual marginal tax rates and the corporate income tax rate provides an incentive for taxpayers to operate through corporate structures where profits can be retained (currently) at the lower 30% tax rate.

It is clear that a reduction in the top marginal tax rate to match the corporate tax rate should leave many taxpayers' ambivalent as to retaining corporate profits. Any rate changes need to be considered as part of the overall tax reform process.

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[115] 2015-16 Budget Paper No. 2, Revenue Measure – Growing Jobs and Small Business – allow immediate deductibility for professional expenses
[116] Such as Division 7A and section 45B of the Income Tax Assessment Act 1936
[117] See PwC Worldwide Tax summaries, http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/United-States-Individual-Taxes-on-personal-income
[118] See PwC Worldwide Tax summaries, http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/United-States-Individual-Taxes-on-personal-income

4.3. Compliance burden for small businesses

The drivers of tax law compliance activities and costs for small business include:

- complex drafting style of relevant tax legislation
- requirement to prepare legal documentation, and
- the Commissioner being able to deviate from the financial statements of a company to deem taxable amounts arising under the deemed dividend rules[119].

An example of complex drafting style is the small business CGT concessions[120]. These provisions are perhaps the most complex income tax provisions for small business to navigate and apply, which is ironic given their purpose is to assist those taxpayers whose tax skills or access to tax resources are limited. Further in many cases the concessions end up being inaccessible due to the threshold criteria being too restrictive and /or the structure employed by the taxpayer. See further discussion below at section 4.4.

An example of the requirement to prepare costly legal documentation can be found in the deemed dividend rules. In many cases, these rules[121] require a complying written loan agreement to be executed prior to the lodgment date of a company providing that loan[122]. We recommend that relevant taxpayers should be able to simply rely upon their income tax returns as sufficient evidence of compliance (as opposed to preparing a separate legal document) as is the case with other elections/choices currently made in respect of other income tax matters.

4.4. Tax concessions available to small business

Although we consider that no changes should be made to the actual concessions available, the drafting of these provisions should be revisited with a view to:

- providing taxpayers with a simple streamlined set of rules to follow
- not limiting their availability due to the structure adopted by the taxpayer, and
- applying less restrictive thresholds to access the concessions.

The small business CGT concessions, for example, are regularly used by qualifying taxpayers with over 19,000[123] taxpayers accessing the small business concessions in the 2012-13 tax year.

However, the legislation is complex and draws in concepts from other parts of the Act with the result that some of the nuances of the provisions are easily overlooked by a less experienced practitioner.

A common error we see involves former advisers failing to correctly identify the taxpayer's 'connected entities' together with their 'affiliates'. Advice is then provided on the basis that the concessions are available, when in fact the thresholds contained in the basic conditions have been breached[124]. Taxpayers are then often faced with large unexpected tax liabilities. A recent example that we encountered resulted in an unexpected tax liability of $250,000.

Whilst the concessions can be significant to certain taxpayers, they are only available in many cases where those taxpayers seek tax advice at the time of establishing their structures. As illustrated by Example 2 above, the small business CGT concessions are less concessional if a company has made a qualifying capital gain as compared to a sole trader or discretionary trust. As such their potential future benefits are currently being outweighed by the upfront cost of ensuring their possible accessibility.

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[119] Section 109Y(2) of the Income Tax Assessment Act 1936
[120] Division 152 of the Income Tax Assessment Act 1997
[121] Section 109N of the Income Tax Assessment Act 1936
[122] See Australian Taxation Office's Fact Sheet "Private Company Benefits – Division 7A dividends" for further details, https://www.ato.gov.au/Business/Private-company-benefits---Division-7A-dividends/Payments-and-other-benefits-affected/Loans-and-other-forms-of-credit/#Fullycommercialloans, 14 May 2015
[123] Australian Taxation Office Taxation Statistics 2012-13, Detailed tables, Capital Gains Tax, Table 1 https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2012-13/?page=27#Capital_gains_tax, 22 May 2015
[124] See definition of 'small business entity' in Subdivision 328-C of the Income Tax Assessment Act 1997 and the 'maximum net asset value test' in section 152-15 of the Income Tax Assessment Act 1997

Furthermore, whilst the current thresholds are inconsistent in their application, in many cases they are too low to ensure small business benefit from the concessions.

The small business CGT concessions require taxpayers to satisfy either the $6 million net asset value test or the $2 million aggregated turnover test. In contrast a $20 million aggregated turnover test applies for the R&D refundable tax offset rules and debt/equity rules.

Private business could benefit from having a consistent set of thresholds applying, and would have greater access to these concessions if the thresholds were increased and indexed annually.

The lower thresholds also encourage 'serial entrepreneurs' to start up a business (such as a café), grow it to a certain level before selling in order to obtain the small business CGT concessions. They then use the sale proceeds to start up a new business and repeat the process. However, adopting this strategy multiple times may mean that entrepreneurs end up with a revenue profit (as opposed to a capital gain) and therefore no longer qualify for the small business CGT concessions.

It is noted that the Board of Taxation in its Report to Government on the *Review of Tax Impediments Facing Small Business*[125] recommended that the small business entity turnover threshold should be increased from $2 million to $5 million, and adjustments to the $6 million net asset value test should be considered[126].

4.5. Decreasing compliance and complexity costs for small business

PwC would endorse consideration of a lower tax rate for small business but encourage the need to have a consistent threshold test for those qualifying for this rate that aligns with the various other tax concessions applying to this sector.

We acknowledge that the Government announced in the 2015-16 Federal Budget that a tax rate of 28.5% would apply to small businesses with an aggregated turnover of less than $2 million from the 2015-16 income year[127]. Although this is a good first step, many small businesses will not be able to access this lower tax rate due to the use of the $2 million aggregated turnover test.

We note there are currently concessions within the income tax legislation that are granted to large business but not small business. An example where concessions exist for widely held business but not for closely held small business is the application of the value shifting rules. These are suspended for large business issuing discounted equity to employees but not when closely held small business undertakes the same commercial activity. Recent changes proposed to the employee share rules to commence from 1 July 2015 are designed to assist the private sector but did not rectify the value shifting rules bias towards large business.

The ATO's adoption of new technologies has assisted small businesses in keeping tax compliance costs down.

Our recent experiences of 'real-time' discussion of transactions with the ATO is also helping to reduce interest and penalty costs which can be significant if issues subject to dispute are not identified until some years later. This ATO initiative should be encouraged.

If other mechanisms such as a single lower tax rate are to be explored, the current definition of small business needs to be revisited to ensure that concessions are appropriately targeted. Perhaps the Corporations Act definition of large company, which by exclusion determines a small company, could be adopted for income tax purposes. Broadly under the Corporations Act,[128] a company is large and therefore not small if it satisfies two of the three thresholds listed below:

- 50 employees
- $25 million turnover, or
- $12 million in net assets.

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[125] Board of Taxation, August 2014, *Report to Government on the Review of Tax Impediments Facing Small Business*

[126] Board of Taxation, August 2014, *Report to Government on the Review of Tax Impediments Facing Small Business* See Recommendation 30

[127] 2015-16 Budget Paper No. 2, Revenue Measure – Growing Jobs and Small Business – tax cuts for small business

[128] Section 45A of the Corporations Act 2001

As a tax rate reduction is seemingly easier to implement (and monitor) than, for example, a CGT concession, perhaps one way forward is to consider a further tax rate reduction which is offset by the removal of some (or all) of the existing small business concessions.

5. Not-for-profit

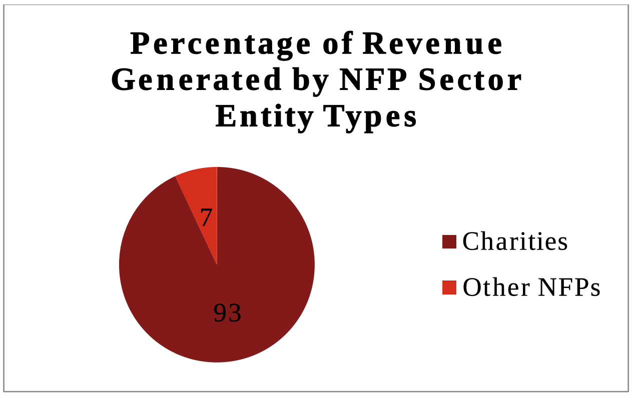
5.1. Appropriateness of current tax arrangements for the NFP sector

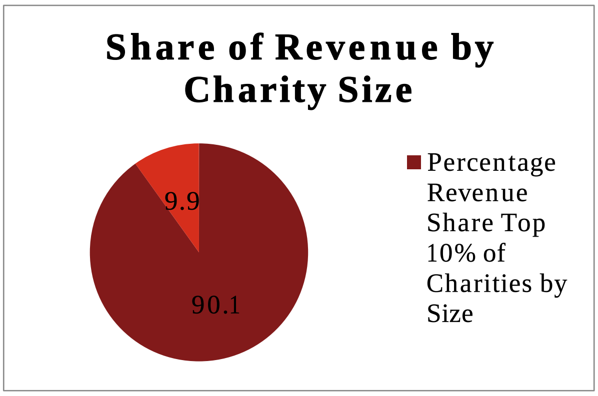
As highlighted in the *Re:think Tax Discussion Paper*, there are a wide range of federal and state tax concessions currently afforded to various types of not-for-profit (NFP) entity. The principle of granting concessions to NFP entities appears to have wide-spread support from the general public, policymakers, and commentators alike, acknowledging that "charitable giving is the lifeblood of civil society"[129]. Tax concessions to charities and NFP entities are part of a desirable policy on the basis that NFP organisations "make a highly valued contribution to community wellbeing"[130].

The ultimate question in determining the appropriateness of tax concessions to the NFP sector is working out whether we have the 'right' balance between the *cost* of supporting the sector, against the extent to which the sector *should* be supported.

There is already a significant amount of revenue foregone in support of NFP entities. The *Re:think Tax Discussion Paper* estimates that by 2017-18 there will be in excess of $1 billion of foregone revenue for gift deductibility alone. The economic cost of supporting the sector is therefore a significant consideration both in terms of the breadth of eligibility for concessions, and the size and scale of the concessions granted.

The two major recent examinations of the NFP sector's activities, undertaken by the Productivity Commission in 2010 and the Australian Charities and Not-for-profits Commission's (ACNC) Charities Report in 2013, emphasised the size, scale, and breadth of the sector's contribution to various aspects of society[131]. The sector maintains a significant presence as an employer, and contributor to the community more generally[132].





Supporting the NFP entities through tax concessions helps to sustain the sector, and facilitates NFP entities' successfully undertaking their philanthropic activities[133] which ultimately should benefit the broader community.

Whether existing tax concessions are appropriate depends upon two key questions:

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[129] J. Malone and R. Young, 26 February 2015, *The Responsibility of Charity: What Constitutes a Charity for Income Tax Purposes* , The Tax Institute 6 ('Malone, Charities'), p 1

[130] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, p 205

[131] Australian Government Productivity Commission, January 2010, *Productivity Commission Research Report: Contribution of the Not-For-Profit Sector*; Australian Charities and Not-for-profits Commission, Penny Knight, David Gilchrist (Curtin University), 24 September 2014, *Australian Charities Report 2013*

[132] Australian Government, September 2013, *Not-for-profit Reform and the Australian Government Report;* Australian Charities and Not-for-profits Commission, 24 September 2014, *Australian Charities Report 2013* , pp 11-14

[133] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, p 206; Malone, Charities p 4

- What is done to support the NFP sector (the 'input question')? That involves considering the overall financial cost of granting tax (or other) concessions, and the types of NFP entity that are supported. How much do we, as a country, put into supporting the sector?
- What does the community gain from the support they provide to the sector (the 'output question')? This may consider the economic benefits such as employment, and the provision of services that may not otherwise be available (or require the commitment of Federal and/or State governments to provide). Given the charitable and benevolent purpose of many NFP entities, this output question may also consider the subjective value of the intangible, non-economic benefits obtained through certain philanthropic activities.

A proper determination and analysis of the input and output of the sector would inform the debate about the appropriateness of the current level of tax concessions by outlining what is given, compared to what is gained by those organisations participating in the NFP sector.

Currently, there is no conclusive guidance or analysis of what is the desired output of the NFP sector. If there were such an analysis, then it is submitted that this could help ensure that any foregone revenue from providing tax concessions is targeted to those in the NFP industry that need it most based on pre-determined benchmarks. It would also be desirable to assess outcomes against set criteria to address any public concerns that NFP concessions are unduly supporting 'less deserving' or 'less needy' organisations.

5.2. Concerns about competitive advantage

We are not aware of any empirical research that attempts to assess the nature and extent of any competitive advantage afforded to the NFP sector, with the exception of the Henry Review[134], which found that income tax and goods and services tax concessions afforded to the NFP sector did not result in any significant market distortion in terms of pricing goods or services.

The Henry Review argued that there is no economic distortion by virtue of NFPs obtaining tax concessions since, as genuine NFP entities are ultimately pursuing activities in order to raise funds for their philanthropic activities, there is no arbitrage or motivation for them to undercut the pricing of goods or services provided by for-profit entities and distort the market-driven price[135].

However, this finding was confined to the pricing of goods or services where the NFP and private sector compete, and did not address competitive advantage in labour markets, which may exist due to FBT concessions. Because of certain concessions, an FBT exempt entity that pays staff through salary sacrificing arrangements is able to pay staff a higher effective wage for the same cost. Whilst the NFP sector is traditionally associated with less-competitive pay than the private sector in many areas, the Henry Review argued that the consequence of FBT exemptions is "particularly problematic in the hospitals sector"[136], where nurses can receive around a 6 per cent higher wage for the same cost to the employer due to FBT exemptions. It found that "the NFP FBT concessions can provide organisations with a competitive advantage in labour markets, by enabling them to pay the market wage at a lower cost"[137]. Refer below to additional comments regarding FBT concessions.

If it is accepted that the NFP sector has some form of competitive advantage over the private sector, at least in certain areas, it must then be determined whether the existence of competitive advantage is problematic. One may contend that a competitive advantage is an intended, or at least, an acceptable consequence of promoting certain NFP activities. The Henry Review supported this point finding that any competitive advantage or bias that did exist was offset by the public benefit that was provided by the sector, and that it was largely confined to select parts of the labour market[138]. Accordingly, tax concessions that may provide competitive advantage need to be appropriately targeted having regard to community expectations of the public benefit provided by the recipient.

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[134] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, p 209 -210
[135] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, p 209
[136] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, p 210
[137] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, p 211
[138] *Australia's Future Tax System report to Treasurer Part Two,* December 2009, pp 208-209

FBT concessions

It is our observation that FBT concessions for NFP entities have existed for many years and have been reinforced through subsequent amendments to the FBT laws (e.g. implementation of capping as an integrity measure). As a result, these concessions have been accepted and integrated into the NFP remuneration framework such that they now form an integral part of employee entitlements, regularly referred to in employment contracts, Industrial Agreements etc, and often form a fundamental role in controlling costs within the NFP sector.

Therefore, it is our view that any consideration to remove or reduce these FBT concessions or exemptions (such as that announced in the 2015-16 Federal Budget[139]) needs to be accompanied with a review of broader funding support for these industries. The challenge for Government and employers alike is that, based on recent analysis undertaken and reviewed by PwC, there would be additional costs of providing equivalent support by way of funding to all employees in connection with the removal of FBT concessions. Accordingly, careful consideration needs to be given to the removal or reduction of these concessions in an attempt to achieve a simple and fair tax system, having regard to potential cost to government, and in a manner that provides for appropriate and equitable transition.

5.3. Simplified administrative arrangements

One of the impacts on compliance costs to NFP sector entities is the multiplicity of regulation that they face at different levels of government. Assuming that a charity is incorporated, operating in all states and territories, and conducting raffles and fundraising, the organisation could be required to deal with 24 different government departments and agencies (and even further agencies could be involved in order to receive local government concessions).

This issue was recognised by the Henry Review which found that 'the system of tax concessions is unnecessarily complex ... [and] [t]his imposes significant compliance costs on NFP organisations', and ultimately concluded that 'the regulatory framework for NFP is inconsistent and opaque'[140].

Some significant developments have been made to streamline the sector by introducing the ACNC, and codifying the definition of charity through the *Charities Act 2013* (Cth). However, disparate definitions and regulations persist across both state and federal regulations.

As a consequence, the recognition as a charity under federal or particular state law, does not guarantee recognition as a charity in another state. It has been our experience that the duplication of state and federal applications and reporting is a burden for the sector. By way of example, PwC is aware of one organisation that was found to be charitable in one state, and then deliberations took place over an 18 month period prior to receiving federal endorsement as a charity from both the ATO and the ACNC who were applying the same or similar common-law tests.

Institutions established for the purpose of promoting a particular industry may be recognised as a charity under the Charities Act, by the ACNC and the ATO, but then may be ineligible for state charitable tax concessions. This is particularly evident in the case of the Western Australian Government's recent reforms of the 'charitable' exemptions from duties, which ostensibly restrict the eligibility of certain fourth limb charities such as 'industrial associations' and 'professional associations'[141].

We submit that one way to reduce this administrative burden that NFP entities (particularly charities) face would be to standardise State and Commonwealth administration of organisations, and, ideally, to introduce greater consistency in the definition of charity, the endorsement or registration of charities, and the eligibility for exemptions across jurisdictions.

[139] 2015-16 Budget Paper No. 2, Revenue Measure – Introducing a cap for salary sacrificed meal entertainment and entertainment facility leasing expenses
[140] *Australia's Future Tax System report to Treasurer Part Two*, December 2009, p 207-208
[141] Duties Act 2008 (WA) section 95, section 96A-C

5.4. Changes that could deliver benefits to the Australian community more efficiently or effectively

One issue that the NFP sector faces is the requirement to raise funding for projects and programs[142]. If the NFP sector had increased access to funding that is tied to accountability for the outcomes delivered, it would encourage projects that deliver efficient and effective community benefits.

One potential method of addressing this problem is to provide tax concessions for investment in social impact bonds. This could work by combining the concepts of social impact bonds, which exist in the United Kingdom[143] and Australia[144], with the exemption concept that applied to infrastructure bonds in Australia, by creating a federal community benefit bond (FCBB) which would be designed to reform public service delivery (see Figure 1 below). Such a scheme would apply with a federal tax concession to the earnings derived from the FCBB while the investor would forego the tax deduction from providing a deductible gift.

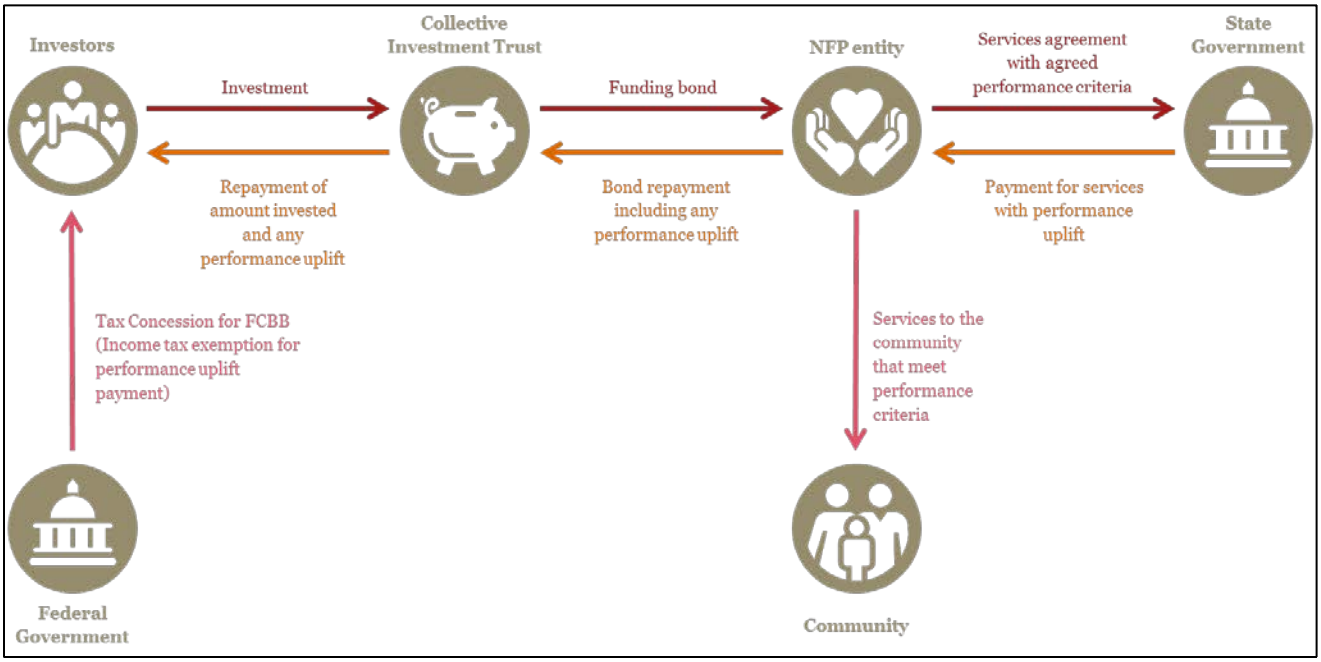
There are two ways in which the tax concession could be applied to support such a scheme:

- an exemption model would result in any income returned from a taxpayer's investment in a scheme that was part of a FCBB to be tax exempt (although an exemption would mean that the quantum of benefits received by investors would be increased for people on top marginal tax rates), or
- a tax offset model could be used that could have a similar operation to the former infrastructure bonds tax offset and carry a flat tax credit/offset.

Importantly, the Commonwealth would be in a position to control the quantum of revenue foregone by only allowing incentives to approved and registered projects, following a review of social benefits that are likely to flow from the project's services and confirmation that the programs are consistent with federal priorities.

These incentives are not intended to replace deductible gifts, but allow for additional funding to be given to the NFP sector in a manner which is linked to performance outcomes in order to support the efficient delivery of community benefits.

Figure 1: Illustration of a Federal Community Benefit Bond scheme



[142] See e.g. Hansmann, *The Rationale for Exempting Nonprofit Organisations from Corporate Income Taxation* (1981) 91 Yale Law Journal 54, pp 69-74
[143]Refer https://www.gov.uk/social-impact-bonds
[144]Refer Social Impact Bonds at http://socialventures.com.au/investment/social-impact-bonds/

6. GST and State Taxes

6.1. The Australian GST system

On and from 1 July 2000, the Australian Government replaced the existing wholesale sales tax system with a multi-staged, broad based goods and services tax (GST). The Australian GST is based on the "value added tax" model adopted by nearly all OECD member countries and more than 80 other countries[145] .

The Australian GST, like many other countries' GST or VAT systems, has unique features. These features either evolved, were necessary to take account of our legal and political system, or have their genesis in the overarching principles that governed the design of the Australian GST law.

Key policy decisions made during 1998 and 1999 were either forced upon the Government (such as the GST-free treatment of food), made after careful consideration of overseas experience (such as the treatment of financial supplies, land, Government, GST grouping and international transactions), or made because it was thought that Australia could improve on the overseas experience in certain areas (e.g. elements of the financial supplies and insurance regimes).

Importantly, the Australian GST law was:

- drafted using the Tax Law Improvement ("TLIP") drafting principles in place at the time, and
- designed to ensure the GST has a neutral impact on taxable businesses.

There was a clear intention when drafting the GST law that:

- GST should not be a factor in businesses making commercial decisions (that is, it should be economically neutral)
- the supplier should not have to ascertain the status of the recipient when determining whether GST applies to a particular transaction. The obvious exception to this rule is the GST treatment of exported goods and services consumed outside Australia
- where possible, cascading of GST should be avoided
- where possible, the GST rules should complement business and accounting practice, and
- the GST law would be based on the "destination principle" with a credit / invoice system.

In our view, these principles are equally relevant today and should remain the touchstone for all GST law changes, whether made to the scope and breadth of its application or its administration.

6.1.1. Structure of the GST law

For the reasons set out in our supplementary submission, *The pathway to a better tax system*, PwC supports a comprehensive broad-based tax system which incorporates the GST as a key part of its operation. In addition to considering broader changes to the GST system, we have identified below a number of areas in which its application and/or administration can be reformed to simplify compliance for businesses.

Broadening the GST base and/or changing its rate

Any discussion regarding broadening of the GST base or potentially increasing the rate cannot be had in isolation. There must be a national conversation about Australia's income and consumption tax mix to properly inform any reform to the GST. As highlighted in our supplementary submission, effective tax reform requires trust in the political and bureaucratic institutions which explain, design and implement reforms. This is essential to assist in community understanding, and to build collective confidence that reforming the overall tax system will lead to better outcomes that also maintain equity and fairness.

As broad-based consumption taxes have a relatively minor distortionary impact on the behaviour of individuals and businesses, it has been shown that they do not impact economic growth to the same extent as other taxes

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[145] Treasurer's media release, August 1998, *Tax Reform: not a new tax, a new tax system*, p 80

such as corporate and (progressive) personal income taxes. This is supported by OECD analysis which estimated that a 1 per cent shift in tax revenues from income to consumption tax would increase GDP per capita by three-quarters of a percentage point in the long run, based on the structure of existing personal income tax arrangements[146].

It is, however, acknowledged that GST is a regressive tax because low income households spend a higher proportion of their income on consumption. Changes to either the breadth or rate of the GST will therefore have a bigger impact on these households (as a proportion of their incomes) compared to higher income households. The extent of these impacts is linked to a person's income and how they spend that income. Accordingly, due to the regressive nature of the GST, any changes to the base or rate of the GST must be accompanied by a compensation package for lower income earners. It would be necessary to consider the appropriate scale of compensation measures, the mechanism by which they are delivered, and how they can be kept in place over the long term. Any compensation mechanism will need to ensure that changes to the interaction between the tax and welfare system do not affect incentives to work or earn extra income.

Recent PwC modelling (see Table 2) shows that broadening the GST base to include health, education and GST-free foods from 1 July 2019, which is the first year after the forward estimates and without any transition phase, would increase state and territory government revenue by around $14 billion in 2019-20, while broadening the base and increasing the rate to 15 per cent would increase state and territory revenue by over $50 billion.

The scenarios below are in nominal terms and assume that other financial flows from the Commonwealth remain unchanged, and do not factor in any other tax changes that may be part of any broader reform package, including any compensation for lower income earners which would reduce the overall net revenue gains.

Table 2: Impact of proposed GST measures

	Baseline	**Broaden** (food, health & education)	**Increase to 12.5%**	**Broaden + 12.5%**	**Broaden + 15%**
Revenue raised by the GST in 2019-20 ($bn)	75.8	89.5	93.0	109.6	128.9
Revenue impact in 2019-20 ($bn)	-	13.7	17.2	33.8	53.1
Annual improvement in operating balance (% of GDP)	-	0.7	0.9	1.8	2.8
States operating balance returns to surplus in:	2015-16	2015-16	2015-16	2015-16	2015-16
States operating balance surplus remains until [147]	2018-19	2018-19	2025-26	2033-34	2043-44

Source: PwC Analysis

Whilst not suggesting that broadening the base and/or increasing the rate of the GST is a panacea solution, PwC considers that reform of the GST must be considered as part of a comprehensive review process if the current reform process is to provide a 'once-in-a-generation' opportunity to examine the whole tax system.

Although the above modelling considers food, health and education, PwC recommends that consideration be given to broadening the GST base to include within its scope goods supplied from overseas directly to Australian customers. Currently, suppliers of such goods are not liable for GST and GST is not collected by Australian Customs when these goods are imported, unless the value of the importation exceeds $1,000. The $1,000 low value threshold for imported goods is high by world standards, but reflects Australia's relatively (by

[146] Johansson, Å. et al. 2008, 'Taxation and Economic Growth', *OECD Economics Department Working Papers*, No. 620, OECD Publishing. Available at: http://dx.doi.org/10.1787/241216205486. [Accessed on 20 October 2014]
[147] Current projections indicate that aggregate state and territory government budgets will move to an operating balance surplus in 2015-16, before returning to deficit in 2018-19. Measures to broaden the base and/or increase the rate of GST will act to delay the deficit, however this assumes that the additional revenue received by governments is not directed towards new expenditure measures.

world standards) low GST rate. The threshold was set to reflect the value above which it is economically viable to collect the GST.

That said, the efficiency of international supply chains and the pervasiveness and convenience of the Internet as a tool for shopping now means that foreign "on-line" businesses are real and significant competitors to local "bricks and mortar" businesses who are registered for and pay Australian GST on their sales. The non-taxable GST treatment of low value imported goods places local GST registered businesses (supplying the same goods) at a significant disadvantage to its unregistered foreign competitors. In our view, this matter should be addressed in the same way that the government proposes to apply GST to the cross-border supplies of services and intangibles in accordance with the 2015-16 Federal Budget announcement[148]. That is, non-resident suppliers of goods should be required to register and account for Australian GST on the sale of "low value" goods (i.e. those below the low value threshold) to Australian consumers, if their GST turnover exceeds the GST registration threshold.

Application to non-residents

In the context of a global economy, our tax system needs to recognise the growing relevance of non-residents. Currently, the GST law brings non-resident businesses with no Australian establishment into its ambit by imposing GST on:

- the acquisition of certain business inputs by non-residents, thereby requiring the non-resident recipient to register for GST purposes and lodge monthly or quarterly Business Activity Statements ("BAS") in order to claim a credit for the GST so charged, or
- the supply of certain goods and real property located in Australia and services supplied to an entity in Australia, even if the recipient is, or would be, entitled to register for GST purposes and claim an input tax credit for the GST so charged.

The 2015-16 Federal Budget announcement[149] and related exposure draft legislation to apply GST to supplies of services and intangibles to Australian consumers will require many more non-resident entities to register for GST purposes and comply with obligations under the Australian GST law.

In order to register for GST purposes, non-resident entities must satisfy proof of identity requirements established by the Australian Business Registrar, even though they are not entitled to an Australian Business Number. The proof of identity requirements are onerous, impractical and actively discourage non-residents from registering for GST purposes.

Under the current requirements, a non-resident applicant must, among other things, provide:

- a certified copy of a non-resident company secretary's birth certificate and passport
- certified copies of three non-resident directors' birth certificates and passports, and
- details of top 20 shareholders for each class of share.

Original documents must be translated into English and certified at an Australian embassy or consulate or by a notary if the documents were issued by a country that is a signatory to the Hague Apostille Convention.

This process is lengthy and cumbersome. Specifically, no regard is given to the nature of the entity seeking registration, the circumstances in which it is seeking registration (many will register and join a GST group with an associated Australian entity), its listing on a foreign stock exchange, the certification process the company has undertaken with its home tax authority, and its compliance record and relationship with its home tax authority. Furthermore, it is unrealistic to expect a non-resident director of a global company to give up his or her passport for any period of time so that it can be translated and certified by an Australian embassy or consulate to prove the identity of the company. A certified copy of local tax registration should be sufficient in most (if not all) cases.

In its review of the administration of the GST law, the Board of Taxation[150] recognised the inefficiency of unnecessarily bringing non-resident entities into the Australian GST system. The Board of Taxation

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[148] 2015-16 Budget Paper No. 2, Revenue Measure GST — applying to digital products and services imported by consumers
[149] Ibid
[150] Board of Taxation, December 2008, *Review of the Legal Framework for the Administration of the Goods and Services Tax*

recommended changes to the GST law to keep non-residents out of the GST system, unless absolutely necessary[151]. The Government accepts the need for such changes but has yet to release legislation to give effect to the Board of Taxation's recommendations.

We recommend that consideration be given to a simplified registration process for entities not seeking to claim input tax credits, as set out in the draft GST law changes associated with the 2015-16 Federal Budget announcement[152]. However, we submit that these changes are merely "papering over larger cracks" in the GST registration system. We submit that in the interests of efficiency that:

- The simplified registration regime should also apply to non-resident entities:
  - registering to join a GST group, or
  - currently registered with a tax authority that has appropriate proof of identity arrangements.
- The GST registration process for non-residents should be divorced from the ABN proof of identity procedures where they are not entitled to an ABN.
- A certified copy of a non-resident applicant's local tax registration certificate or letter should be sufficient in most (if not all) cases to prove the identity of the applicant.

6.1.2. *Simplifying the administration of GST*

In 2008, the Board of Taxation in its report on the *Legal Framework for the Administration of the GST*, made 46 recommendations to improve the administration of the GST. Most of these recommendations were originally accepted by the Government. However, on 14 December 2013, the then Assistant Treasurer announced[153] that a number of these recommendations would not be proceeding. We submit that the following issues should be revisited as they would make GST administration for affected businesses simpler, reduce compliance costs and not result in a loss of revenue to the Commonwealth.

Although detailed background information in relation to each of these issues is set out in the Board of Taxation's 2008 report[154], we have briefly summarised the relevant issues below. We are happy to provide further information if necessary.

Allowing holding companies to register and group

Entities that only passively hold investments in other entities ("holding companies") are not entitled to register for GST purposes (as they are not carrying on an enterprise) and as a consequence, cannot join a GST group with associated entities. In effect, the GST grouping rules do not recognise that a holding company is part of one economic entity. The Board of Taxation recommended that holding companies should be entitled to register for GST but only for the purpose of joining a GST group[155].

We note that New Zealand amended its GST law in 2006 to allow holding companies to register and group for GST purposes.

We submit that this recommendation was sensible, uncontroversial and provides certainty to businesses that, on occasions may need to register such entities, particularly if it incurs GST on costs. Currently, in order to register a holding company it is necessary for the company to conduct economic activities which it would not otherwise undertake. This is often done to effect an entitlement to register for GST purposes, but it unnecessarily increases compliance costs and increases risks for those less well versed in the nuances of the GST law.

We submit that the GST law should be amended to allow holding companies to register for GST purposes in order to become a member of a GST group.

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[151] Recommendation 26 of Board of Taxation's *Review of the Legal Framework for the Administration of the Goods and Services Tax*, December 2008
[152] 2015-16 Budget Paper No. 2, Revenue Measure GST — applying to digital products and services imported by consumers
[153] Assistant Treasurer's media release, 14 December 2013, *Integrity restored to Australia's taxation system*
[154] Board of Taxation, December 2008, *Review of the Legal Framework for the Administration of the Goods and Services Tax*
[155] Recommendation 32 and paras 7.1.30 to 7.1.32 Board of Taxation's *Review of the Legal Framework for the Administration of the Goods and Services Tax*, December 2008

Adjustments for changes in use

The GST law requires registered entities to make adjustments to input tax credit claims where there has been a change in the use of a business input. The "change of use" rules in the GST law are unnecessarily onerous and result in significant compliance difficulties for affected entities[156].

In particular, the Board of Taxation stated the following in its report at paragraph 2.2.33:

> "The Board considers that there is significant room to improve the GST rules relating to adjustments for changes in use. The present law is overly complex, having too many differing thresholds and drawing a generally unhelpful distinction between business finance and other types of activity. The periods over which adjustments are to be made are often excessive. Moreover, there is often insufficient consistency between the compliance obligations created by various GST provisions dealing with change in use as well as in similar rules in other areas of the tax law."

We submit that the Government should revisit its December 2013 decision[157] not to proceed with a review of the "change in use" provisions in the GST law. Simpler laws in this area will improve compliance, reduce compliance costs for affected businesses and not negatively affect revenue collection.

Vouchers

The Board of Taxation addressed the treatment of vouchers in its 2008 report[158].

The GST treatment of vouchers is unnecessarily complex, unfair and out of date with current technology. The voucher provisions were drafted as a consequence of food becoming GST-free. Vouchers (including prepaid phone cards) with a face value are not subject to GST on supply but are treated as consideration for a supply on redemption. The issuer of the voucher is the entity liable for GST on redemption and the value of the consideration is deemed to be the face value of the voucher.

Too often the voucher provisions in the GST law result in GST being paid at an effective tax rate greater than 10%. This is because face value vouchers are transferrable and often sold by the issuer (and purchasers of the voucher) at a discount to its face value. Consequently, the issuer of the voucher is required to account for GST on the face value of the voucher when it is redeemed which is often significantly more than the amount the issuer received for the voucher (or the amount that anyone in the commercial chain received for the voucher). In our view this strikes at the integrity of the GST law and should be rectified.

We also note that the current legislation to deal with vouchers was drafted before electronic vouchers were developed and debit cards became increasingly used as a substitute for the traditional paper type voucher.

We submit that it is time to review the GST law applicable to vouchers to appropriately address "electronic vouchers" and to clarify what type of "voucher" (if any) require special rules that effectively tax them on redemption.

6.2. State taxes

A relative priority for state and local tax reform should be the reform, and ultimate abolition, of conveyancing stamp duties (both from a private, residential property perspective and a business, commercial perspective) and the replacement with a broad based land tax. In short, as outlined in the *Re:think Tax Discussion Paper*[159], this is because conveyancing stamp duties have a high excess burden (i.e. high long term costs for living standards, measured as the 'marginal excess burden') because they discourage the exchange of residential and business properties. Conversely, a broad based land tax has a relatively low excess burden.

The next reform priority should be around removing the current inefficiencies attaching to Australia's payroll tax system by way of removing the payroll tax thresholds, harmonising the law across the States and Territories and simplifying its administration.

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[156] Refer to Board of Taxation, December 2008, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, Chp 2, specifically paras 2.2.16-2.2.19 and 2.2.31-2.2.44
[157] Assistant Treasurer's media release, 14 December 2013, *Integrity restored to Australia's taxation system*
[158] Board of Taxation, December 2008, *Review of the Legal Framework for the Administration of the Goods and Services Tax*, Chp 2.6
[159] *Re:think Tax Discussion Paper*, 30 March 2015, p 24

6.2.1. ***Stamp duties and land taxes***

The inefficient and distortive nature of stamp duties from a residential property / housing affordability perspective has recently been well documented in the report by the Senate Economics References Committee into housing affordability, "*Out of reach? The Australian housing Affordability challenge*", tabled 8 May 2015. The additional costs imposed by conveyancing stamp duties discourage people moving elsewhere to more suitable housing and similarly prevent others from moving into housing which may better suit their needs. The stamp duties also distort decision making in the choice between buying versus renting and moving house versus renovating. This directly impacts labour mobility and economic productivity.

From a business perspective, a tax which supports entrepreneurship, investment and job creation should be a priority. Conveyancing stamp duties on business transactions work against this. We are aware of many instances where the additional stamp duty cost of acquiring an asset has restricted a potential acquirer from acquiring the asset. Moreover, where multiple bidders have been concerned, some of the bidders have withdrawn from the tender process due to the impact of duties on acquisition cost. This directly impacted the competitive nature of the tender process and hence the price obtained for the asset. It is a clear illustration of a tax impeding the efficient operation of the market.

Not only has stamp duty considerations impacted on a business decision as to whether or not to acquire an asset from a third party, but it has also impacted on the decision to restructure internally towards a more efficient, desirable ownership structure. Whilst there are generally stamp duty exemptions/concessions for internal group reorganisations, the conditions for relief differ between the Australian jurisdictions. Some States have more onerous conditions for relief than others. This, too, is a clear illustration of a tax impeding the efficient operation of the market in that a decision to restructure or not may depend on whether an exemption/concession is available in a particular State, and if it is available, it may be subject to different conditions depending on the State.

This complexity and lack of harmonisation between the States leads to arbitrary and sub-optimal business outcomes as a decision to proceed or not with a restructure, for example, may hinge on the extent to which the relief applies in a particular State or not. There are numerous other examples where not only does the imposition of stamp duty to certain transactions differ between the States, but also the exemptions/concessions.

Furthermore, the costs, time and utilisation of resources in understanding and complying with the different laws in the different States are unnecessarily higher than they should be. This also distorts the efficient allocation of resources as those resources taken up in understanding and complying with the different laws could be put to a better alternative value adding use.

Accordingly, a replacement tax that would not have such a distortive/inefficient economic effect is also preferred from a business/commercial perspective. Again, as in the case of residential property, we believe such a replacement tax should be a broad based land tax.

We believe that by ultimately replacing all forms of stamp duty with a broad based land tax, the objectives of balancing equity and efficiency would be achieved. In this respect, refer to our publication *Protecting prosperity: why we need to talk about tax* (at page 31)[160]:

> *The growth advantage of taxes on immovable property has increased as globalisation has increased. Land and fixed assets provide a very stable tax base, as these items cannot escape overseas to avoid taxation, and tax rates can be low and very broadly spread. Every business and every household needs somewhere to operate and live. These taxes do not affect the decisions by individuals on the supply of their labour and there is no disincentive to working longer, seeking promotion or investing in education.*

[160] PwC, July 2013, *Protecting prosperity: why we need to talk about tax*, p 31

We also believe that a broad-based land tax should:

- be levied based on a per-square-metre value of individual land parcels as this will address equity issues as well as reflect the economic use of the land
- apply to all sectors (i.e. preferably residential and non-residential) with a concession, rebate or deferral of tax for those most vulnerable members of the community (e.g. pensioners or low income earners), and
- be phased in over time.

We consider a sensible approach would be to adopt an approach similar to that in the Australian Capital Territory with a transitional phasing out of conveyance duty over a reasonable period of time while increasing land based taxes to cover any revenue shortfall. This approach should minimise the impact to households and distortions to the property market.

6.2.2. ***Payroll taxes***

In our previous publications[161], we have identified that payroll tax itself is an efficient tax, however its effectiveness and efficiency in Australia is largely reduced by the progressive increases over time in the payroll tax-free thresholds across the various states and territories, which creates a disincentive for established small businesses to grow and creates significant administrative and compliance costs for employers. Accordingly, we submit that the first priority for tax reform for payroll taxes is to remove the tax-free thresholds, allowing payroll tax to be levied evenly across all businesses, and to reduce the rates. This would be consistent with the best practice of applying a broad base and low rate that would have less distortionary effects.

Further reforms should also be considered to reduce the complexity for businesses of adhering to the current differing state based payroll tax regimes. In this regard, the priorities for state tax reform of payroll taxes fall into three categories – consistency, ease of administration and clarity – which are further canvassed below.

Consistency

While payroll tax is an efficient tax, minor variations between each state, and also with the Commonwealth, in the context of fringe benefits, add significantly to complexity for relatively little tax impact. Steps have been made to achieve harmonisation between the states under the *2010 Harmonisation Joint Protocol*[162], however there remains some significant inconsistencies that require businesses to consider when applying payroll tax law for each state and territory in which they operate. These differences in tax treatment arise in the fundamental unit of payroll taxation being the taxable wage base, and are found on items such as parental leave, long service leave and apprentice wages. It is our view that the establishment of a common wage base applicable to each state and territory would promote uniformity and reduce unnecessary complexity for business operating across the nation.

In addition, differences between the various state tax laws and the federal income tax law with regard to how and when remuneration is recognised for tax purposes create unnecessary complexity for negligible tax impact. The most prevalent example is the timing of recognition of Employee Share Scheme (ESS) income.

Currently, for example, some states will tax employee share options when restrictions lift, while other states will tax options when they are exercised. By aligning the timing of the taxing point of ESS income, this will allow employers to capture the income that is reported on the Employee Share Scheme Statements that are prepared for the ATO, rather than requiring employers to consider and track the timing of the taxation point for, not only, Federal income tax and reporting purposes, but also for each state in which they operate. In this respect, we recommend that ESS income be recognised uniformly at the state level, and at the same time as it is recognised for federal income tax purposes.

Ease of administration

The administration of the various payroll tax regimes across Australia creates a level of inefficiency for an otherwise efficient tax. Employers are required to file monthly payroll tax returns in each state in which they

[161] PwC, July 2013, *Protecting prosperity: why we need to talk about tax*, pp 41-43
[162] A Protocol for Payroll Tax Harmonisation between Jurisdictions (Signed 28 July 2010)

operate; the registration process is specific to each state; the annual tax returns are all different and need to be filed separately. All of this is completed by businesses, in addition to its Federal reporting obligations.

It is our view that businesses would benefit from the creation of a uniform administration and collection system to support the state payroll tax regimes. The most efficient process for this would be to incorporate the payroll tax reporting and remittance process into the BAS reporting process. This alignment of Federal and State reporting requirements would not only ease the burden on businesses of attending to distinct reporting processes each month, but it would also remove an element of duplicated collection processes by the revenue authorities – the current system results in nine different collection authorities (viewing the ATO as one collection point, covering superannuation guarantee, Pay-As-You-Go withholding and FBT), simply for the collation of taxes paid by employers on employment costs.

As an alternative to a unified collection process, another way to simplify the administration process would be to create a state taxes portal (like the ATO's Business Portal) that feeds from each state's tax system and administration process, and through which a business's entire state payroll (and other) tax matters could be centrally managed. Refer also to our comments in section 7 of this submission relating to complexity in the tax system.

Clarity

It is our experience that the three most consistent issues addressed by the state revenue authorities when undertaking payroll tax audits are grouping, ESS and contractors. The regularity of these matters arising indicates that there is a lack of clarity around the interpretation and application of the laws relating to these areas. However, our recommendations around removing the payroll tax-free thresholds and aligning the treatment of share scheme income will go a long way towards removing, or resolving, these complex matters.

Payroll tax grouping rules are designed as an anti-avoidance measures to ensure that employers cannot claim multiple payroll tax thresholds by spreading out their employment obligations amongst a series of linked companies. Therefore, if payroll tax thresholds are removed, there will no longer be a need to group companies – every employer will pay payroll tax from the first dollar of their payroll.

The taxation of ESS is complicated. However, by aligning each state's taxation of ESS income to the Federal tax treatment, employers will no longer have to consider the different timing taxing points for ESS income, and will be able to capture the reportable income of the Employee Share Scheme statements lodged with the ATO, generating better clarity and ease of application for the businesses.

As Australian businesses follow the global trend of moving to more flexible and contingent workforce models, the use of contractors increases. Unlike the income tax system, which typically shifts the employment tax burden directly onto a (genuine) contractor, the state revenue authorities seek to include contractors as part of a business's payroll tax liability (subject to a series of exemptions that may apply). This limits a contractor's ability to claim the payroll tax threshold in their own right, hence limiting a loss of tax revenue to the state authorities. However, the treatment of contractors continues to be a regular source of audit activity, indicating the confusion that this treatment creates for the business community. By removing the payroll tax thresholds, there will no longer be a tax difference between a contractor being taxed as part of its customer's business and being taxed in its own right, hence removing the need for complex legislation to influence who has responsibility for the payroll tax liability.

In summary, we have suggested the following areas for reform of the current payroll tax system:

Consistency

- Removal of the payroll tax thresholds and lowering the rates.
- Establish a common wage base (eliminating minor variances such as parental leave; long service leave; apprentice wages).
- Align the income recognition rules to the income tax rules - particularly around timing of ESS taxing points.

Ease of administration

- Incorporate the payroll tax reporting and remittance process into the BAS reporting process.
- Alternatively, create a system through which state tax matters could be centrally managed - registration of employers; lodgment of payroll tax returns; assessment process.

Clarity

- Provide greater clarity on grouping rules (grouping rules will be less necessary if the payroll tax threshold is repealed).
- Provide greater clarity on contractor rules (noting that the revenue benefit of the contractor rules will be far less if the payroll tax threshold is removed).

6.3. State mining royalties

We submit that harmonising the methodology used to calculate and administer state and territory royalty regimes applicable to mining and oil and gas projects is desirable as it will provide investors with greater clarity and comparability in managing investments across Australia. Each state or territory could retain autonomy with respect to the rate of royalty it wishes to apply (including the ability to provide royalty holidays etc). A harmonised methodology would make investment choices and compliance easier for investors without inhibiting the state and territories prerogative to determine the rent they require for the exploitation of their resources.

For the calculation of royalties, a profit based method may be more effective than ad-valorem royalties in encouraging the efficient use of Australia's mineral resources. This is because a flat rate of tax on output or turnover can cause marginal projects that would otherwise be profitable to become unviable. A profit based method should help support the viability of such projects.

Clearly, any changes to state/territory royalty regimes would need to respect the fact that investment decisions for existing projects have been made based on the existing regimes. In this respect, grand-fathering/opt-in arrangements should be considered as part of any changes to ensure existing projects are not unfairly impacted. In this respect, governments should engage in genuine consultation with affected companies so that appropriate transitional arrangements are put in place to ensure existing investments are not unfairly impacted.

7. Complexity and governance

7.1. Reducing complexity

PwC has long held concerns regarding the complexity of Australia's tax system. Complexity is clearly the hidden cost of our tax system, and is far greater than often recognised. Complexity in Australia's tax system creates uncertainty for taxpayers, increases costs to comply with tax obligations and can also lead to increased tax disputes with the revenue authorities.

As acknowledged in the *Re:think Tax Discussion Paper*, the causes of complexity are diverse, and PwC agrees that the factors contributing to complexity are many and varied, ranging from tax policy settings to compliance and administration. In our experience, it is business, through their own tax obligations and also their obligations to collect tax on behalf of Government, that is most affected by, and bears the greatest cost of, complexity of the tax system, and in many cases, this cost is passed on to employees or consumers. Tax compliance complexity represents a major cost for business, with a common complaint being the need to provide data necessary to populate annual, quarterly or monthly tax forms with information required by the relevant tax collection authority for its own use and for the use of others (e.g. for Government statistical purposes) and in dealing with different revenue authorities across the nation.

It is our experience that there has been some progress in reducing complexity by changes in the manner in which law is developed, following the work of the Tax Design Review Panel in in 2008 and the Board of Taxation's Post-implementation Review of the Recommendations made by the Tax Design Review Panel in 2011. In addition, the Government's deregulation agenda[163], which aims to deliver a net annual red tape reduction of $1billion per annum by reviewing the existing regulations, including tax law, has the potential to make significant inroads in the area of tax system complexity by simplifying specific areas of the tax law which have been identified as overly complex (for example, the TOFA provisions).

In *Paying Taxes 2015*[164], a joint report prepared by the World Bank Group and PwC, Australia compared favorably in terms of tax compliance obligations (number of hours to comply and number of tax payments per year) to other countries in the Asia-Pacific region. However, there is still work to be done in reducing the complexity of the tax system to achieve the goal of lower, simpler and fairer taxes. PwC recommends that the following suggestions for improvement be considered:

- Reducing the number of taxes, for example, through State tax harmonization and reduction in inefficient State taxes. Treasury has previously estimated that Australia has at least 125 different taxes, and if differences in taxes levied at the State level are taken into account, there may be up to 259 taxes nationally[165]. These figures are not likely to have significantly changed in recent years, as the process of harmonization and elimination of inefficient state taxes has stalled in most States due to revenue pressures.
- Greater coordination in the administration of taxes at the Federal and State level. This could include the establishment of a centralised tax collection agency, which was suggested by PwC in its submissions to *Australia's Future Tax System Review* in 2009, and similar to the approach adopted in Canada where provincial governments enter into 'tax collection agreements' with the Federal government to harmonize and streamline the collection of taxes at both levels. A similar approach in Australia has the potential to deliver significant benefits for both governments, through administrative efficiencies, and taxpayers, by providing a single point of contact for all tax compliance matters. Also as outlined in section 6.2.2 of this submission, the use of the existing BAS for reporting payroll taxes is another possible improvement of the administration of the overall tax system.
- Simplification of certain areas of the tax law. Throughout this submission we have suggested a number of ideas that can assist in simplifying specific aspects of the tax system, for example, tax treatment of losses and capital allowances. In our experience, the most complex areas of Federal income tax law are the income

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163 Whole of Government deregulation agenda, http://www.dpmc.gov.au/office-deregulation/whole-government-deregulation-agenda

164 PwC and the World Bank Group, *Paying Taxes 2015: A global picture*, http://www.pwc.com/gx/en/paying-taxes/index.jhtml

165 Australian Treasury, 6 August 2008, *Architecture of Australia's Tax and Transfer System*, Section 2.3, http://taxreview.treasury.gov.au/content/Paper.aspx?doc=html/publications/papers/report/section_2-03.htm

tax provisions relating to TOFA, tax consolidated groups, foreign sourced income (including the CFC regime) and the taxation of trusts. We acknowledge that work is already underway, or scheduled to commence in 2015, to review the rules relating to TOFA and tax consolidated groups, and it is hoped that simplification will be a key focus of these reviews. In relation to the treatment of foreign sourced income, we recommend that the Government undertake a review of this area following completion of the OECD's work on BEPS. In the context of State taxes, the differing payroll tax laws and the application of the payroll grouping provisions are those which our clients are most likely to get wrong (refer our comments under section 6.2.2 in this submission).

- The introduction of a statutory remedial power for the Commissioner of Taxation to overcome technical deficiencies in Federal tax and superannuation laws in favour of the taxpayer, which should help solve technical issues without the long delays associated with legislative amendments. PwC welcomes the announcement[166] from Assistant Treasurer the Hon. Josh Frydenberg MP on 1 May 2015 confirming that the Government intends to proceed with this matter, which has been in development for over 18 months, and we look forward to seeing how it may actually be implemented.
- The introduction of administrative 'safe harbours' to reduce the compliance burden on certain groups of taxpayers. PwC supports moves within the ATO to develop 'safe harbours' in respect of certain Federal tax matters, evidenced by the recent establishment of safe harbor working groups[167] that are aimed at identifying avenues to reduce red-tape in relation to excise, alignment of tax and accounting, FBT and remuneration, GST and for small to medium enterprises. It is important, however, that care is taken in the development of these safe harbours to ensure that they do in fact deliver real compliance savings (see, for example, our comments in section 3.5.2 regarding transfer pricing safe harbours for small taxpayers and low-value transactions[168]).
- Greater use of technology to simplify the administration of Australia's tax system. Refer to comments below at section 7.2 specifically addressing this issue.

It must be recognised that there will always remain a degree of complexity with our tax laws, including through inherent uncertainty in fundamental areas such as matters relating to valuations, transfer pricing, and the application of the general anti-avoidance provisions and the application of the relevant law to specific facts. Underpinning that is the important but difficult role that the administrator has in enforcing compliance with taxation laws. However, it is equally important that this role be undertaken with consistency, and in an efficient manner that makes best use of resources, minimises the time and resources required by taxpayers, and encourages voluntary compliance by taxpayers. PwC has made submissions to the Inspector-General of Taxation and the House of Representatives Standing Committee on Tax and Revenue in relation to their inquiries into income tax disputes and the role of the ATO, and our comments made there, whilst focused on need for independent, objective and professional dispute resolution and proper governance of the dispute resolution process, are equally relevant in the context of addressing complexity in the administration of the tax system and easing the compliance burden[169].

7.2. Improving tax administration by embracing technology

The way in which the tax system is administered by the ATO and other tax authorities can play a key role in achieving the Government's stated goal of lower, simpler and fairer taxes. As noted above, tax compliance complexity is a major cost to business, and is clearly an area where there is much to gain through improving the administration of Australia's tax system, with technology being a key enabler in this area. Whilst the adoption of technology presents a number of challenges, it has the potential to radically change, and simplify, the way Australia's tax system is administered. PwC believes that there are many benefits of embracing technology as part of tax administration including:

[166] Assistant Treasurer, 1 May 2015, *Providing more certainty and better outcomes for taxpayers*, http://jaf.ministers.treasury.gov.au/media-release/021-2015/
[167] Australian Taxation Office, 30 April 2015, *Matters under consultation*, https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/Matters-under-consultation/
[168] Australian Taxation Office, December 2014, *Simplifying transfer pricing record keeping*, https://www.ato.gov.au/Business/International-tax-for-businesses/In-detail/Transfer-pricing/Simplifying-transfer-pricing-record-keeping/
[169] We can provide these submissions on request

- greater level of compliance through ease of use and automated data capture
- reduction in compliance costs for taxpayers
- reduction in potential for errors
- greater convenience
- faster response times, and
- reduction in costs to administer the tax system.

The New Zealand government has recently commenced a process to reform the administration of tax in New Zealand, with an initial focus on delivering better digital services to help realise the benefits of technology[170]. The reform process in New Zealand is based on an over-arching principle that services must be designed for the customer, with the following supporting principles:

- Principle 1: No one size fits all
- Principle 2: Tax compliance and access to entitlements are critical
- Principle 3: Change will not be imposed without careful consideration of the costs and benefits

These principles, and the broader work underway in New Zealand, can assist with the development of a process of tax administration reform in Australia which focuses on digital solutions and technology.

PwC also supports the work currently underway by the ATO to reinvent the taxpayer experience, and we acknowledge the significant amount of work performed up to this point as part of the *Reinventing the ATO* program. The *Reinventing the ATO - Program Blueprint*[171] sets out five guiding principles for the reinvention of the ATO, and the provision of contemporary, digital experiences is a strategic program of change in the blueprint.

With this in mind, we comment below on a number of key principals (some of which relate directly to those in the ATO's blueprint) which PwC believe are critical for success in the delivery of digital solutions to enhance the administration of the tax system. These are:

- integrate the collection of tax information into natural systems
- optimise the use of data and harmonise reporting obligations, and
- engage with a wide range of stakeholders and acknowledge and respond to the challenges.

7.2.1. ***Integration into natural systems***

Integrating the collection of tax information into natural systems and processes would be a major step forward in reducing the cost of compliance as it reduces the need to duplicate processes for different purposes. As highlighted in the discussion paper issued by New Zealand's Inland Revenue, "*this kind of integration with existing processes – in particular, business accounting systems – is a way of delivering services designed with the customer foremost. This kind of approach could deliver significant benefits to customers by eliminating the need for them to deal with routine tax matters as a separate exercise*"[172].

Integrating tax collection into natural systems can deliver benefits for both individuals and businesses, but requires collaboration between tax authorities and third parties, including tax software developers, developers of business accounting systems, and financial institutions. Examples may include integrating tax classifications into accounting systems, or allowing individual taxpayers to "tag" income and expenses through online banking systems. The challenge here is to incentivise third parties to work with the Government to deliver these solutions by identifying the value proposition for software changes[173] or possibly entering into cost sharing arrangements.

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[170] New Zealand Inland Revenue, 31 March 2015, *Making Tax Simpler: Better digital services*, a government discussion document, http://taxpolicy.ird.govt.nz/sites/default/files/2015-dd-mts-2-better-digital-services.pdf
[171] Australian Taxation Office, March 2015, *Reinventing the ATO – Program blueprint*, http://reinventing.ato.gov.au/
[172] New Zealand Inland Revenue, 31 March 2015, *Making Tax Simpler: Better digital services*, a government discussion document, page 23, http://taxpolicy.ird.govt.nz/sites/default/files/2015-dd-mts-2-better-digital-services.pdf
[173] Australian Taxation Office, March 2015, *Reinventing the ATO – Program blueprint*, p 8, http://reinventing.ato.gov.au/

The Government's recent initiative to introduce "Single Touch Payroll" is a good example of the way technology can be integrated into existing business processes to reduce compliance costs. The ATO's discussion paper on implementation of Single Touch Payroll estimates that a business with 6 employees may have to currently complete in excess of 400 manual transactions each year to meet their employer reporting and payment obligations[174]. The introduction of Single Touch Payroll capabilities from 1 July 2016 will make use of third party payroll software to integrate the employers reporting and payment obligations (PAYG withholding and superannuation obligations) with existing payroll functions.

7.2.2. ***Optimise the use of data and harmonise reporting obligations***

The importance of "data" in the digital economy is well acknowledged. The ATO's blueprint for change highlights "smarter data" as a key strategic program for change, with the ATO intending to use data and data analytics to create and maintain a real time view of taxpayer's positions, their current circumstances and compliance behavior.

Another key aspect to the use of data in ATO administration is to design systems through which a single set of data is used to meet a range of reporting obligation across a range of different taxes and obligations administered by the ATO, including GST, PAYG, income tax and superannuation guarantee. Data matching and pre-filled tax returns, using the data currently already being submitted to the ATO, could significantly reduce the compliance burden on taxpayers, particularly for small businesses (for example, information regarding sales and purchases on quarterly or monthly BAS could be used to pre-fill income tax returns for business taxpayers).

In our view, a simpler tax system could be achieved by adopting this approach, and then further expanding this initiative to harmonize reporting obligations across different Government agencies and different levels of Government, and even overseas tax authorities, for example:

- payroll tax reporting and payment obligations for state revenue authorities
- Australian Securities and Investment Commission (ASIC) reporting obligations, and
- international tax filing obligations such as those under the US Foreign Account Tax Compliance Act (FATCA), and the OECD's proposed country-by-country reporting model (as announced in the 2015-16 Federal Budget[175], to be adopted in Australia for certain large multinationals from 1 January 2016) and Common Reporting Standard for automatic exchange of financial account information (CRS). PwC has lodged a submission on the Treasury discussion paper on CRS[176], released in June 2014, and we refer you to our comments in that regarding harmonization of reporting obligations.

The benefits of such an approach have already been identified by the Government in the Treasury discussion paper *Improved tax compliance – enhanced third party reporting, pre-filling and data matching*[177], where it is acknowledged that State or Territory government agencies often have access to information which could be used to enhance data matching and pre-filling of tax returns.

There will, of course, be a number of challenges in implementing this approach - however it has the potential to significantly improve the taxpayer experience and reduce compliance costs. The use of software that incorporates Standard Business Reporting (SBR) should assist furthering this objective. As already noted above, the Government may need to consider further initiatives to incentivise third party developers to invest in and develop compatible software products.

7.2.3. ***Engage with stakeholders and acknowledge the challenges***

It is important to acknowledge that there is no "one size fits all" solution to improving tax administration through the adoption of technology. Different taxpayers have different interactions with tax authorities, and hence have different needs, and these must be addressed in developing a range of technology avenues through

[174] Australian Taxation Office, February 2015, *Single Touch Payroll discussion paper*
[175] 2015-16 Budget Paper No. 2, Revenue Measure – Combatting multinational tax avoidance – new transfer pricing documentation standards
[176] Australian Treasury, June 2014, *Common Reporting Standard for the Automatic Exchange of Tax Information, Discussion Paper*
[177] Australian Treasury, February 2014, *Improved tax compliance – enhanced third party reporting, pre-filling and data matching, Discussion Paper*

which taxpayers can have dealings with the tax authorities. To ensure that these needs are met, it is necessary to engage with a wide range of stakeholders in the development of these digital solutions.

PwC supports the approach adopted in the ATO's blueprint for change, which clearly reflects an understanding within that organisation that digital solutions must be tailored for different types of taxpayers. We have also evidenced increasing engagement between the ATO and various stakeholders regarding the implementation of new digital solutions, including the recent establishment of a consultation project to canvass the community's readiness to more to digital interactions[178].

As noted above, the use of technology to improve the administration of Australia's tax system is likely to present a number of challenges that must be overcome. These include:

- Data security. This is essential to protect confidential taxpayer information, and to encourage uptake of new technology.
- Co-ordination across levels of government and internationally. This may include, for example, addressing legislative barriers which may prevent data sharing.
- Implementation and transition costs. These can be significant for first time adoption of new technology, but should in the long term be outweighed by compliance cost savings. The Government may wish to consider types of support that can be provided to mitigate high implementation and transition costs.
- Speed of technological change. The rapid speed of changes in technology can often mean that technological advancements are out of date before they can be implemented. Accordingly, in designing new technology solutions, there is a need to anticipate trends and create solutions that can easily be adapted to technology changes.
- Access to technology. It is critical that the design of new technology solutions takes into account that some taxpayers will not have access to technology required to access digital services. The ATO's current consultation project, *Enabling Digital by Default*, acknowledges this issue, stating that "*Under this model, taxpayers with the functionality and capability to interact digitally will be required to do so. Those who are unable to transition to digital services will be exempted and alternative services made available to them. However, in applicable circumstances, ongoing assistance and support will be provided to eventually transition taxpayers to online and other digital services*"[179].
- Organisational capability. Delivering effective digital solutions is a specialised skill set that is very different to the traditional skill set of tax professionals. There must be investment in new resources to deliver effective digital solutions.

PwC acknowledges that these challenges are significant, and the process of delivering digital solutions in not a simple one. However, in our view, the long term benefits of utilising effective digital solutions in the administration of the tax system are likely to far outweigh the costs involved in developing these solutions.

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[178] Australian Taxation Office, 30 April 2015, *Matters under consultation – Administration: [201524] Enabling Digital by Default*, https://www.ato.gov.au/general/consultation/what-we-are-consulting-about/matters-under-consultation/administration/#FIS201518

[179] Australian Taxation Office, 30 April 2015, *Matters under consultation – Administration: [201524] Enabling Digital by Default*, https://www.ato.gov.au/general/consultation/what-we-are-consulting-about/matters-under-consultation/administration/#FIS201518

Appendix B

References to discussion questions

Discussion question	Submission reference
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?	Refer to 'The pathway to a better tax system'
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?	Throughout Detailed submission
3. How important is it to reform taxes to boost economic growth? What trade-offs need to be considered?	Refer to 'The pathway to a better tax system'
4. To what extent should reducing complexity be a priority for tax reform?	Throughout Detailed submission
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?	Throughout Detailed submission
6. What should our individuals income tax system look like and why?	Detailed submission, Section 1
7. What should our fringe benefits tax system look like and why?	Detailed submission, Section 1.4
8. At what levels of income is it most important to deliver tax cuts and why?	Refer to 'The pathway to a better tax system'
9. To what extent does taxation affect people's workforce participation decisions?	Refer to 'The pathway to a better tax system'
10. To what extent are the interactions between the tax and transfer system straightforward for the people who deal with both systems?	N/A
11. How important is tax as a factor influencing people's decisions to work in other countries?	Detailed submission, Section 1.5
12. To what extent is tax planning a problem in the individuals income tax system? Are existing integrity measures appropriate?	Detailed submission, Section 1.1
13. What creates incentives for tax planning in the individuals income tax system? What could be done about these things?	Detailed submission, Section 1.1
14. Under what circumstances is it appropriate for assistance to be delivered through tax offsets?	Detailed submission, Section 1.2
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?	Detailed submission, Section 1.3

Discussion question	Submission reference
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?	Detailed submission, Section 1.4.1
17. To what extent are the concessions and exemptions in the fringe benefits tax system appropriate?	Detailed submission, Section 1.4.2
18. What tax arrangements should apply to bank accounts and debt instruments held by individuals?	Detailed submission, Section 2.1
19. To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?	Detailed submission, Section 2.2
20. To what extent does the dividend imputation system impact savings decisions?	Detailed submission, Section 2
21. Do the CGT and negative gearing influence savings and investment decisions, and if so, how?	Detailed submission, Section 2.2
22. How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?	Detailed submission, Section 2.3
23. What other ways to improve the taxation of domestic savings should be considered? How could they be applied in the Australian context?	Detailed submission, Section 2
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?	Detailed submission, Section 3.1
25. Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?	Detailed submission, Section 3.2
26. To what extent would Australia benefit from the mutual recognition of imputation credits between Australia and New Zealand?	N/A
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?	Detailed submission, Section 3.3
28. How complex is the tax treatment of capital assets and are the costs of compliance significant?	Detailed submission, Section 3.3
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?	Detailed submission, Section 3.4
30. How could the current tax treatment of intangible assets be improved?	Detailed submission, Section 3.3.2

Discussion question	Submission reference
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?	Detailed submission, Section 3.5
32. To what extent does the tax treatment of foreign income distort investment decisions?	Detailed submission, Section 3.5
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?	Detailed submission, Section 3.5
34. How can tax avoidance practices such as transfer pricing be addressed without imposing an excessive regulatory burden and discouraging investment?	Detailed submission, Section 3.5.2
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?	N/A
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?	Detailed submission, Section 3.6
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?	N/A
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?	Detailed submission, Section 3.7
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?	Detailed submission, Section 3.8
40. What other taxation incentives, including changes to existing measures, are appropriate to encourage investment in innovation and entrepreneurship?	Detailed submission, Section 3.9
41. What effect is the tax system having on choice of business structure for small businesses?	Detailed submission, Section 4.1
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?	Detailed submission, Section 4.1.1

Discussion question	Submission reference
43. Is the interaction of the personal and business tax systems a problem? What can be done to manage the personal-business tax interactions?	Detailed submission, Section 4.2
44. What are the most significant drivers of tax law compliance activities and costs for small business?	Detailed submission, Section 4.3
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?	Detailed submission, Section 4.4
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?	Detailed submission, Section 4.5
47. Are the current tax arrangements for the NFP sector appropriate? Why or why not?	Detailed submission, Section 5.1
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?	Detailed submission, Section 5.2
49. What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?	Detailed submission, Section 5.3
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?	Detailed submission, Section 5.4
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, fairer?*	Detailed submission, Section 6.1
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?	Detailed submission, Section 6.2 Refer to 'The pathway to a better tax system'
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?	N/A
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?	Detailed submission, Section 6.1

Discussion question	Submission reference
55. To what extent are the tax settings (i.e. 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?	N/A
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?	Detailed submission, Section 7.1
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?	N/A
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?	Detailed submission, Section 7.1
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?	Detailed submission, Section 7.2
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?	Detailed submission, Section 7.2
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?	Detailed submission, Section 7.2
62. Would there be benefits in integrating the administration of taxes across the Federation? If so, what would be required to realise these benefits?	Detailed submission, Section 7.1 and 7.2
63. What changes could be made to provide greater certainty, transparency and accountability to tax policy development in Australia?	Refer to 'The pathway to a better tax system'
64. Are current tax review arrangements appropriate? How could they be improved?	Refer to 'The pathway to a better tax system'
65. Could the arrangements for developing tax policy in Australia be improved? If so, how?	Refer to 'The pathway to a better tax system'
66. Would the benefits of releasing more tax data and detail around costings outweigh the costs?	N/A