

## Taxation Law Committee

### Tax Discussion Paper

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*Tax White Paper Task Force  
The Treasury  
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The NSW Young Lawyers Taxation Law Committee (the **Committee**) makes the following submission in response to the Tax Discussion Paper.

## NSW Young Lawyers

NSW Young Lawyers is a division of the Law Society of New South Wales. NSW Young Lawyers supports practitioners in their professional and career development in numerous ways, including by encouraging active participation in its 16 separate committees, each dedicated to particular areas of practice. Membership is automatic for all NSW lawyers under 36 years and/or in their first five years of practice, as well as law students. NSW Young Lawyers currently has over 15,000 members.

The members of the **Committee** are young practitioners from NSW who share an interest in, and passion for, taxation law. The Committee represents a group of emerging legal practitioners who will be the forefront of tax planning advice and tax disputes over the coming years.

This submission has also been prepared with the assistance of the Public Law and Government Committee of NSW Young Lawyers.

Inquiries may be directed to Elias Yamine, President of NSW Young Lawyers or to Nathan Weinberger, Chair of the Committee (contact details below).

## Foreword

The Committee has provided a response to the following questions: 5, 6, 11, 14, 16, 19, 21, 22, 23, 40, 42, 44, 52, 53, 54 and 62.

In preparing our response, the Committee has focussed on issues which may be of a greater concern to younger Australians including: housing affordability, superannuation, start-up companies and small businesses and issues surrounding fairness and the impact of Australia's taxation system on lower income earners.

## **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?**

A progressive income tax system for individuals is an important starting point to maintain fairness in Australia's tax system. Notwithstanding issues concerning bracket creep, a progressive tax system helps to maintain fairness by only increasing an individual's tax rate as their income increases, so tax is borne by individuals in proportion to their capacity to pay. The tax-free threshold also plays an important role in maintaining fairness by providing additional relief to low income earners.

Making Australia's tax system simpler would go a long way to improving its fairness by making it easier for individuals to understand their tax obligations. The more complex a tax system is, the more difficult it is to understand, and the more difficult it is to understand, the more taxpayers need assistance from tax professionals to manage their tax affairs effectively. It is low income earners who cannot afford to engage a tax professional who are the most adversely affected by a complex tax system.

The problem of bracket creep could be overcome by indexing marginal tax rates to inflation as this can help incentivise workforce participation for lower to middle income earners.

It is also important that business does not disproportionately pass on its tax costs to other areas of the economy (via lower employee wages and charging higher prices for goods and services). It is submitted that lowering the corporate tax rate could go some way to maintaining fairness in Australia more broadly, whilst encouraging entrepreneurship and innovation.

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

One area where the Committee believes there is room for improvement in the income tax system for individuals is in relation to the concessional treatment on superannuation contributions. The reduced tax rates applicable to superannuation contributions disproportionately favour higher income earners with excess income available. One way of remedying this would be to reform the way superannuation is taxed, so that the tax paid by an individual on their superannuation contributions is equivalent to their marginal tax rate. This would allow the federal government to capture additional revenue on the superannuation contributions of higher income earners. This may be a disincentive for individuals to plan effectively for their retirement. It will be necessary to balance these

interests to ensure that additional revenue can be captured whilst not preventing individuals from planning for their retirement.

## **11. How important is tax as a factor influencing people's decisions to work in other countries?**

There is little evidence to suggest that tax is an important consideration in influencing a person's decision to work in another country. It is more likely that individuals are more motivated to work overseas due to such factors as the quality and diversity of work opportunities as opposed to tax considerations. The existence of double taxation treaties and the taxation of Australian source income irrespective of where a person resides means that they will still be required to pay tax on their Australian source income. Also, the perceived attractiveness of lower marginal income tax rates in other countries such as the UK and USA may be negated by the higher consumption taxes which these countries impose. HECS and HELP repayments in Australia may lure some young workers overseas temporarily, however it is unlikely that having to repay these debts would keep Australians overseas in the longer term.

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

One area where it is appropriate to grant tax offset assistance is in circumstances which will reduce government spending in the longer term. For example, it could be considered appropriate to grant a tax offset for private health insurance uptake if this means that the overall burden on the Medicare system will be reduced over the coming decades. However, as with many policy considerations this would need to be balanced against other initiatives such as broadening the GST base (which is discussed further in response to question 54 below).

## **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?**

Our Fringe Benefits Tax (FBT) system is generally viewed as a 'support system' for personal income tax. It allows employees to reduce their salary, by receiving a benefit such as a car or loan (for personal use), whilst the employer pays tax on the 'taxable value' of the benefit (at the top marginal rate). Any benefit that is for work use, will not result in FBT, and will not be claimable as a deduction by the employee.

However many, particularly those in small business, view FBT as an extremely complex area of tax law. Many employers do not understand the ramifications of their FBT decisions and therefore try to avoid FBT or mistakenly think it does not apply. This can result in employees missing out on potential benefits and some employers running the risk of audits and penalties. The current FBT system provides a list of categories of fringe benefits, into which a fringe benefit must fit. The rules for determining the taxable value of the fringe benefit depend on the category of the benefit. Additionally, the personal or business use of the fringe benefit needs to be calculated. There is also an independent FBT year, from 1 April to 31 March.

The FBT system is viewed by many as being imbalanced because it allows employees of organisations such as benevolent Institutions or some non-profit entities, public hospitals and religious organisations to receive concessional treatment. Whilst this reduces salary costs for a sector that has difficulty competing with salaries provided in the profit sector, this can create a tension with the principle of equity between employees in different sectors.

One way that Australia's FBT system could be improved is by following the recommendation of the Henry Review, namely that "[f]ringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system." This is the most efficient solution and would result in greater 'benefit' prospects for employees as employers would not have to bear the tax burden of providing fringe benefits to their employees.

## **19. To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?**

Whilst the CGT discount encourages taxpayers to invest in capital assets, this should be balanced against the current economic and social climate. It is therefore submitted that the CGT discount should be reconsidered. It creates a distortion in investment decisions, and together with negative gearing, artificially inflates the housing market. It also creates a bias toward complex trust structures for asset holding in order to access the discount and detracts from the progressivity of the income tax system overall, by creating a more favourable tax outcome for capital gains (which are only available to those with the capital to invest) as compared with ordinary income.

The 50% CGT discount was introduced following the Ralph Review in 1999, however the Review did not explain how the discount was determined and whether it was intended to be permanent or temporary. The rationale for the discount was efficiency, to create an incentive for investing. We submit that the current CGT discount is not appropriate. It is

inequitable and inefficient and the best policy would be to remove the CGT discount, to ensure symmetry between the way gains and losses are treated.

In the alternative, we are of the view that a generally fairer outcome could be achieved with a return to the indexation method. A return to the indexation method could be done transitionally (i.e. more generous indexation for an initial period) to reduce the impact on property and share markets in the short term. Whilst indexation requires a more complex calculation as technology improves, the burden of complexity is reduced (i.e. better accounting and tax return software to automate calculations).

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

As above, we are of the view that the CGT discount should be removed or replaced by the indexation method.

Negative gearing, especially in relation to residential properties, should also be reconsidered as it is likely that it has had a significant impact on housing affordability. Nevertheless, we do see that there could be a benefit in retaining tax concessions afforded by negative gearing in relation to newly built residential properties only as this may encourage the supply of new housing and help alleviate cost of housing pressures. Appendix 2 of the Financial System Inquiry: Final Report notes that the CGT discount may “encourage leveraged and speculative investment, with lenders having greater exposure to mortgages. Housing is a potential source of systemic risk for the financial system and economy”. This demonstrates that there are other economic ramifications resulting from the tax treatment of negative gearing, notwithstanding the fact that many taxpayers may be indifferent when it comes to the different tax treatment of debt and equity financing.

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

The taxation of superannuation funds in accumulation phase should be reconsidered. The rationale of providing a concessional tax environment to incentivise saving for retirement cannot be said to extend to the extremely large balances and earnings of some funds. There is no reason that a progressive marginal tax system should not also apply to superannuation. It should still be low enough to incentivise contributions by being significantly more favourable than individual marginal rates.

By imposing tax based on the income of the fund, and not the income of the individual or the balance of the fund, complexity around contributions and withdrawals could be reduced. Tax on withdrawals could be reduced or simplified as a result. Withdrawal conditions could also be reviewed and simplified.

Any such changes to the taxation on the earnings of a superannuation fund should only apply prospectively to the earnings on contributions made after the announcement of this measure. This would ensure that those who have previously made contributions based on the old rules are not unfairly disadvantaged.

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

The question of how to improve the taxation of domestic savings will depend on achieving the optimal combination of factors that encourages productivity and long term growth of the Australian economy. For instance, given the declining terms of trade and increasing Budget deficit, a delicate balance will need to be achieved between the efficacy of raising revenue for the Government and ensuring there is a fair taxation of savings for income earners, irrespective of their level of income.

Although it may be helpful to consider foreign tax regimes of domestic savings (such as Norway's dual income tax system), any consideration of how to improve the current regime of taxing domestic savings should be specifically tailored to Australia's current and future financial, economic and social environment (i.e. issues surrounding housing affordability and how to fund Australia's aging population).

The productivity and long term growth of the Australian economy will depend on a number of factors, including whether there is incentive for businesses to invest in Australia. In particular, section 6.1 of the Tax Discussion Paper notes that small business account for 43% of private non-financial employment and 33% of private non-financial sector production. Given its significant contribution to the Australian economy, any proposed changes to the taxation of domestic savings should not result in disincentive for small businesses to invest or save in Australia.

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

The tax system needs to reflect the distinction between a 'small business' and a 'startup'. A startup will necessarily be loss-making for an initial period, and may not even have any significant revenue for some time. While small businesses will remain an important part of the economy, true innovation and long term job creation is much more likely to come from startups than small businesses.

Tax incentives in the 2015/2016 federal budget are much more helpful for small businesses than startups. There does not need to be a definition for this distinction, but the government needs to be cognisant that measures which benefit small businesses do not necessarily benefit startups.

The main needs of startups (which can be addressed by the tax system) include access to investor capital, access to quality employees and simplified compliance obligations. The tax system should facilitate access to capital by broadening concessions like the Early Stage Venture Capital concessions. The ESOP changes are long overdue and are welcomed by Australian startups.

Concessions should also be available to 'angel' investors who invest directly in very early stage companies and for whom access to capital is very limited. A good example of this is the UK's Enterprise Investment Scheme, and the S-corp flow through structure.

## **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?**

A flow through structure such as an S-corp should be considered, to incentivise innovation in early-stage companies.

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

One of the most significant drivers of tax law compliance activities and costs is the reporting requirements for a number of taxes, such as preparation and lodgement of business activity statements (BAS), instalment activity statements, income tax returns, fringe benefits tax returns and payroll tax returns. These reporting requirements are likely to reduce the time, labour and other resources of small business owners that may otherwise be spent on investing in its business operations.

The level of tax law compliance activities required will vary depending on the business structure, its objectives and the stage of the business lifecycle in which it sits. The level of tax law compliance activities will also dictate the need for small business owners to obtain tax advice. Significantly, the cost of obtaining tax advice is fixed, irrespective of the size of the business, and this gives rise to a significantly disproportionate amount of tax compliance costs falling on small businesses.

Given the complexity of Australia's tax law, it is likely that small business owners may not have the requisite knowledge to properly apply the relevant tax law or claim the appropriate tax concessions if completing their own tax compliance activities. Therefore, it is necessary to balance the costs of tax law compliance with the risk of non-compliance by small businesses that may be incorrectly applying tax law.

## **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?**

A crucial issue facing Australians is housing affordability. As a large portion of the state government's revenue comes from taxes associated with land, housing affordability should be a key consideration when considering state tax reform. As stamp duty on the transfer of land is a transaction tax it can be seen as further contributing to the issue of housing affordability. Stamp duty disproportionately disadvantages first home buyers and low income earners by pushing up the effective price of purchasing a home. The ACT reforms which remove stamp duty in favour of a broader land tax may be a solution worth further exploration. While land tax does require the payment of tax where there is not necessarily a corresponding cash inflow, this could be overcome through implementing concessions for properties under a certain threshold or for low income earners. Another option could be to introduce a reverse mortgage method for the payment of land tax for low income earners (similar to that existing for municipal rates in the ACT and South Australia). Imposing a greater tax on the holding of land may also discourage the purchase of investment properties, and may help alleviate pressures on the supply side of housing. While not strictly a transitional cost, the removal of stamp duty may result in more transactions taking place in the housing market in the short term, as the real cost of selling and purchasing property may reduce. However like with the implementation of the GST, it is likely that this would merely be a one-off cost.

Finally any consideration of state and local tax reform should focus on increasing the efficiency of state taxes, as state governments (generally speaking) only have access to the most inefficient taxes out of all levels of government.

**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?**

Having access to a sufficient source of revenue is crucial for any government to maintain its autonomy. Currently state governments only generate 55% of their revenue with the balance coming from grants from the federal government. To provide state governments with greater access to revenue to finance new spending decisions there are two options. One option is to share the collection of taxes between the federal and state governments, and the other is to alter the means by which the federal government provides revenue to the states.

There is ample precedent for the sharing of taxes between state and federal government with Germany, Switzerland and Canada all sharing income tax between their state and federal governments. Further, Canada even shares the imposition and collection of its value added taxes between its state government equivalents and its federal government, (however this option is most likely not available due to state governments being unable to impose taxes on goods due to section 90 of the Constitution). Due to constitutional limitations on the Australian federal government imposing different rates of taxes on different states, practically speaking, state governments are unable to implement income taxes, without it leading to a greater rate of tax being imposed in that state. Accordingly, if state governments were to share some taxes (like income tax) with the federal government, all states would be required to agree to impose the same rate of tax, so the federal government could then correspondingly reduce its rate of tax, to not lead to an overall increase in the tax rate imposed in any one state.

The other option for enabling state governments to finance new spending decisions is for the federal government to increase the proportion of general purpose payments and reduce the proportion of specific purpose payments it makes to the states. Specific purpose payments currently make up around 21.5% of the revenue of state and territory governments. By imposing fewer conditions of the funds distributed to the states from the revenues associated with GST, state governments would have a much greater discretion to spend the money they receive from the federal government as they see fit.

It should be noted that any consideration in relation to providing access to sufficient funding for state governments needs to be done with the understanding of maintaining the current level of horizontal fiscal equalisation (HFE). The federal government needs to

maintain a certain level of vertical fiscal imbalance to ensure that those states which generate less revenue are still able to maintain a minimum standard of the services they provide so that all Australians, irrespective of the state in which they reside, can access services of a sufficiently high quality.

In respect of the federal government levying taxes on mobile bases, due to the constitutional limitations described above, we are of the view that it is crucial that this be done at a federal level, as state governments do not necessarily have the same means available to do so. Also the emergence of the digital economy presents several challenges in ensuring the security of mobile revenue bases. To address the challenges of the taxation of mobile bases Australia should adopt a unified, federal approach and not a piecemeal state by state approach.

## **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?**

Broadly, we are of the view that Australia has an appropriate mix of taxes on specific goods and services. However, in determining the mix of taxes on specific goods and services, a careful balance must be struck between ensuring this mix generates a sufficient source of revenue and does not disadvantage low income earners.

### **GST-free status of certain goods and services**

As the GST is a regressive tax, any changes to the base or rate should be carefully considered before being implemented to ensure those on low incomes are not unfairly disadvantaged. There are however two areas where the GST base could be expanded with minimal impact on low income earners. Removing the GST-free status of private health insurance and private education could provide access to an additional revenue stream without impacting low income earners, as only those Australians who can afford these services will be impacted. We do however acknowledge that such reforms need to be considered in conjunction with other government policy so as to ensure they do not result in increasing the burden on the public health and education systems.

### **Indirect taxes and food**

While we acknowledge that there is a significant compliance burden for businesses involved in the production and sale of fresh food in determining whether or not an item is considered 'fresh food' for the purposes of the GST Act, we believe the GST base should not be broadened to include fresh food. As noted above, being a regressive tax any changes to the GST base to include fresh food will impact those on low incomes the

most. Further, with Australia's food prices already amongst some of the highest in the developed world, actions to increase the price of fresh food may discourage some Australians from making 'healthy' food choices. Fresh food should be as affordable as possible, as promoting access to fresh food helps promote a healthy lifestyle, which in turn may help lower government health expenditure.

An alternative option to raise additional revenue from food could be to implement a 'junk food' tax. A junk food tax could encourage Australians to make healthier food choices and make the price of fresh food comparatively more affordable.

A junk food tax may however raise similar compliance and administration issues to those associated with the GST-free status of fresh food and it could be difficult to determine a metric (i.e. sugar, salt or fat content) against which an item is to be measured as junk food. Some of these compliance and administration issues could be overcome through the enacting of legislation as to what constitutes 'junk food' like the guidance found in the ATO's detailed food list and the use of a prescriptive as opposed to a proscriptive approach to determining what is and is not 'junk food'. Such an approach would help reduce any uncertainty. Enacting similar legislation in relation to fresh food could also assist in reducing compliance costs in relation to the GST-free status of fresh food.

### **Indirect taxes and luxury goods**

When the GST was introduced in 2000, the price of many luxury goods fell. Under the previous sales tax regime many luxury goods were taxed at 32%. The effect of this reduction led to the luxury car tax and the wine equalisation tax being implemented to help mitigate the reduction in the tax rate for these goods. Luxury goods such as jewellery, watches and furs had no such tax applied. It is suggested that consideration should be given to implementing a luxury goods tax (to bring the tax on these goods such as jewellery, watches and furs back to pre-2000 levels) as it would be in line with the policy behind the luxury car and wine equalisation taxes, would provide an additional source of revenue and would have little or no effect on low income earners as only those with the capacity to purchase luxury goods would be subject to the tax.

### **GST on imports and online transactions**

The GST exemption on imports under \$1000 and associated issues with ensuring GST is charged on online transactions presents a significant challenge for the competitiveness of local small businesses. Reform in this area is also a difficult issue in that the administrative and compliance costs of enforcement may outweigh the revenue generated. In relation to the charging of GST on online transactions, unilateral action by Australia is unlikely to be effective. It is suggested that working with the OECD/G20 Base Erosion Profit Shifting 15 point action plan and through the use of multilateral agreements

and reciprocal agreements between jurisdictions is likely to be the most effective way of addressing this challenge and consideration of this issue should be deferred until the action plan is finalised.

## **62. Would there be benefits in integrating the administration of taxes across the Federation? If so, what would be required to realise these benefits?**

### **Duplication and efficiency**

One benefit of integrating the administration of taxes across the Federation would be the cost savings on the administration associated with the collection of taxes. Currently it is likely that there is duplication between state and federal governments in the collection of taxes. Streamlining the administration of taxes across federation would also help ease the compliance burden for individuals and businesses alike. In the case of businesses, state payroll tax could be remitted as part of the BAS process, reducing the compliance costs associated with lodging a BAS and then having to separately account for payroll tax to the relevant state government revenue authority. Likewise, land tax could be remitted as part of a business' or individual's income tax return, again easing compliance costs by reducing the number of returns which need to be made by each taxpayer, each year.

The difficulty in realising these benefits is the difference in the rates, exemptions and valuation methods of the taxes in place in each state. This would make the administration of taxes somewhat complex if centralised in one government agency as public servants would need to be familiar with the different tax laws in force in every state in Australia. This could be overcome by state governments agreeing to a certain level of harmonisation in relation to the kinds of taxes or the rates of taxes levied. It is important to note that this may be difficult to implement and care would need to be taken to ensure that such action would not impede upon the already somewhat limited autonomy of state governments to make their own decisions regarding taxation to fund spending decisions which they wish to make.

It would also be important if this was implemented to ensure that the revenue raised by each state was accounted for separately and not intermingled with revenues from other states or the federal government, otherwise it could lead to the integration of the imposition of revenue, not just the integration of the collection of revenue.

## **Identification of tax avoidance**

In addition to cost savings, integrating the collection of both state and federal taxes in one government agency could also help identify tax avoidance, by having each taxpayer record all their information in one return. When a stamp duty liability was triggered on the sale of a property or shares, this could signal that a capital gains tax liability should be incurred. Alternatively where a property is rented, this could signal that there should be a corresponding land tax liability being recorded.

## Concluding Comments

NSW Young Lawyers and the Committee thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

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