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Tax Forum
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Dear Tax Forum,

Tax Forum

The Australian Bankers' Association (ABA) represents the banking industry in Australia. ABA members are major taxpayers and key participants in the tax and transfer system, and have a keen interest in all aspects of tax reform.

Throughout the current tax reform process, the ABA has maintained that there should be no large-scale changes in the way that Australia levies tax, particularly with respect to businesses. Rather, as a mid-level economic power, Australia should determine its general direction for tax changes based on international consensus as reflected in country practice and international agreements, while ensuring that Australia remains an attractive destination for inbound investment and a significant base for outbound investment.

Importance of the financial system

The importance of the Australian financial system and its stability to the Australian economy has been much in the news recently. In the light of the ongoing problems in the global financial system we consider that the need for our general approach of staying in the mainstream has increased.

The global financial system has suffered a number of shocks over recent years causing significant financial turmoil. Significant tax changes also can cause economic shocks as the ongoing tax debate about the potential effects of the MRRT and the pricing of carbon has highlighted. The ABA does not take a position on these particular issues, which are in any event not the subject of the discussions at this Tax Forum. What we would emphasise is that the tax system should not place greater stress on the financial system and should not obstruct the effective operation of that system.

Incentives to work and fairness

The ABA agrees that the tax system should not create undue disincentives for work (all taxes on labour will have some disincentive effect) and that the tax system should be fair as between individuals. Others at this Forum will have much to say on these issues.

ABA members have direct experience of some of the problem areas. They have large numbers of staff, particularly in branches, who have children in childcare. Members have noted the sensitivity of these staff members to the tax and general treatment of childcare. We support measures that make it easier for Australians with children to work, with minimal interruption to their careers and productivity. There is significant evidence that once staff withdraw from the workforce because of a lack of affordable childcare, even for a relatively short period, there can be permanent effects on their careers.

Similarly the ABA has concerns about the increasing trend towards income testing of benefits that raise effective tax rates on staff with children and exacerbate adverse career and productivity effects.

The ABA does not offer solutions in these areas as it has not undertaken the detailed work required but we urge the Government to move forward in addressing these now well known issues.

Incentives to save and invest

The main issues where the ABA has undertaken considerable work and commissioned research concern incentives to save and invest, business income taxation, state taxation and tax administration. We will now turn to these issues, which are of great concern to the ABA.

The modern economic literature indicates that the traditional apparently self-evident efficiency and equity claims for the comprehensive income tax base ignore household production, household exchange and untaxed forms of leisure. A broad income tax base may not produce the most desirable efficiency and fairness outcomes at the individual level. Departures are justified if they can be shown to produce greater economic efficiency, and either advance fairness, or at least do not have significant adverse effects on fairness.

When looking across countries, it is noticeable that such departures are significant with respect to savings by individuals. There is a general trend to remove or reduce taxes on individuals' income from capital. Australia already has a number of measures in place which are broadly consistent with international norms in this area (such as the superannuation system and capital gains discount).

Part of the explanation of these measures is a rough and ready adjustment for inflation, which has impacts on income from capital that do not apply to labour income. There are other factors such as the greater mobility of capital, myopic savings behaviour etc.

One particular and simple form of individual saving that is currently subject to tax disadvantages, is the savings or deposit account. Efficiency and equity will be improved by providing more favourable tax treatment for such accounts and the international trend is in this direction.

There are two necessary elements to policy in this area concerning deposits accounts of residents and borrowings from non-residents. These issues are noted in the Tax Forum Discussion Paper and the Government has already announced some measures in this area, though there has been a delay in implementation.

Apart from mobilising savings, such measures are very important to stability of the Australian financial system. ABA members have noted recently that spreads on international borrowings are trending to levels experienced at the height of the global financial crisis and ratings agencies are once again commenting on the exposure of the Australian financial system to foreign lenders because of a domestic deposit base that is smaller than the ratings agencies regard as appropriate.

We consider that three measures should receive some priority in order to address this ongoing problem in the stability of our financial system – an exemption for deposit accounts of residents which is simple and does not entail significant compliance costs for banks or individuals, an exemption from interest withholding tax for non-residents with retail domestic deposit accounts, and an exemption from interest withholding tax for wholesale borrowings from non-residents.

Although action has been signalled by Government, the ongoing risk to the financial system indicates that action should occur earlier rather than later.

Business income taxation and competitiveness

With respect to the taxation of business and investment income derived through entities like companies, another crucial factor in assessing the tax system is international competitiveness.

Australia needs to remain in the mainstream so far as the corporate tax rate is concerned, both for general competitiveness reasons and to reduce incentives for income shifting. This will require a gradual reduction in the company tax rate. The Government has already announced the first step in this process, but in the view of the ABA the Government should commit to further reductions within specific periods as it has done in the past and other countries have done more recently. The reductions do not need to be deep and we consider that the 25% rate indicated as a target by the Henry Review is a sensible medium term goal.

We do not consider that Australia needs further reform of its corporate tax arrangements at this time such as the tax treatment of equity as raised in the Tax Forum Discussion Paper. In the last decade there have been very significant changes including the debt equity, thin capitalisation, consolidation, simplified imputation and TOFA rules which have not yet been fully bedded down.

Other major countries have not moved away from a corporate income tax and Australia should not seek to be a leader in this area. Further it should maintain the imputation system, which has been a significant factor in the integrity of the corporate tax system in Australia and the investment by average Australians directly or indirectly in Australian companies.

State taxation

By contrast to the corporate income tax, State tax arrangements in Australia are out of line with international norms, particularly the heavy reliance on stamp duties on land transfers and insurance. The ABA has been involved in commissioned research in this area modelling a number of possible changes to state tax arrangements that would be revenue neutral and increase economic efficiency with considerable payoffs.

The most efficient broad based taxes used to fund the states are land taxes, payroll taxes and the GST. The most inefficient taxes are stamp duties and motor vehicle tax. The last of these raises a number of special issues and is not commented on further here.

Our modelling indicates that there are a number of possibilities involving elimination of stamp duties on land transfers and insurance combined with increases in the coverage and/or rate of the more efficient taxes that should be feasible within a medium term timeframe. Although the Government has ruled out changes to the GST rate, that still leaves possibilities in the land and payroll tax areas for making up the revenue shortfall from abolishing stamp duties which should be actively pursued.

The ABA does not support a new cash flow style tax as the alternative revenue source for states. Although often advocated in the economic literature, such taxes are rare internationally and would involve Australia moving into unknown waters.

Tax administration

Tax administration is an overlooked issue in relation to international competitiveness. Certainty and transparency are highly important in establishing a country as a desirable place for investment and placement of funds management and multinational company activities. Australia will advance competitiveness by having a "one-stop shop" for taxation so far as possible, provided that certainty in tax outcomes can be achieved.

A one-stop shop would also have bottom up benefits in relation to State taxation. Companies with purely Australian operations would have reduced compliance costs if they have only to deal with one tax administration, and such a framework will facilitate harmonisation of the tax base rules, while leaving States with freedom in relation to rates and exemptions.

At the moment, Australia has too many overlapping anti-avoidance rules in many of its taxes, effectively leaving many tax outcomes to administrative discretion that is not exercised in a consistent way. Such discretions should be removed or significantly reduced in number and scope. Broader operational efficiencies, as well as compliance benefits, will also be produced by these changes in tax administration.

There have been examples overseas of tax changes in recent times that put increased stress on the financial system, in particular the US rules about disclosure of foreign bank accounts held by US taxpayers. These changes are causing very significant compliance costs for the Australian financial sector without any offsetting benefits in Australia as there has been no suggestion that US taxpayers are hiding substantial funds in Australian bank accounts. We consider that Australia should seek to prevent or reduce costs of these kinds being imposed by foreign tax systems on our taxpayers in general and our financial sector in particular. We also caution that Australia should balance the costs and benefits in relation to the impact of Australian tax compliance on the financial sector.

Answers to the specific questions posed in the Forum discussion paper are attached.

The ABA welcomes the opportunity to participate in the Forum, and looks forward to the discussion on the day.

Yours sincerely

Tony Burke

Attachment: ABA Responses to Tax Forum discussion questions

ABA Responses to Tax Forum discussion questions

Discussion paper questions	ABA response/position
Broad approaches to the tax and transfer system	
(1) At the Commonwealth level, are there opportunities to further balance the tax system towards more efficient revenue bases?	Although a destination-based cash flow tax is theoretically seen as a more efficient tax, the potential introduction of such a tax needs to be considered in the context of the global market in which we compete (i.e. Australia is a mid level power and needs to align our tax regimes with our major trading partners and countries in the region to remain competitive) as well as the reality that another "new" tax will bring with it complexity, additional administration (for tax authorities and businesses), loss in business and investment certainty for a period and additional tax interpretational issues. Two common destination-based cash flow taxes are sometimes referred to as either a "full" destination based cash flow tax; or a "VAT-type" destination based cash flow tax. The full model is essentially a tax determined by dividing up the worldwide profit of a multinational firm on the basis of where it makes sales to third parties rather than where it produces its output. All costs associated with making such sales would be deductible irrespective of where they are incurred. The VAT model is essentially a model that taxes revenue from third parties, exports are tax free, imports are taxed and costs are allowable as a deduction in the country in which they are incurred. Essentially it is identical to a VAT except that domestic wage costs would also be deductible from the tax. In a paper by Stephen Bond and Michael P. Devereux in February 2002 entitled "Cash Flow Taxes in an Open Economy" they concluded that in certain situations, the full tax model will induce the location of production to move to an offshore jurisdiction. This movement was more likely when the parent of the multinational operated in a country larger than the operation in question. In the VAT

Discussion paper questions	ABA response/position
	model however, the tax should not, theoretically, have an impact on the location of operation. At first glance therefore the VAT model might be preferred. [1] In practice however, it is important to note that practical application of a tax, particularly a new one, by a business can be challenging. Fundamental interpretation issues, simplicity of the tax, closer alignment with existing understood concepts of taxation, implementation costs and issues, ongoing compliance costs, global competitively, the level of government support, consistency and fairness of application, simplicity of the rules, and business certainty are factors to consider. A VAT model more closely aligns with those aspects. It is important to note however that efficiency benefits for the government do not always translate into greater benefits, greater certainty or reduced compliance for businesses. As a result, given the potential for the loss in the domestic economy in a full destination cash flow tax, a VAT style destination based cash flow tax would appear preferable. It would however be unusual and inefficient to implement a destination based cash flow tax based on a VAT given the existence of a GST in Australia. Australia's GST system is more mature and businesses have built systems to appropriately capture, report and remit GST. Many interpretational issues have been resolved. Implementing another tax will bring with it the inherent need to build new separate systems, require separate and duplicated reporting, additional interpretation issues and require separate government departments (at either the State or Federal level) responsible for

[1] The Devereux work has been subject to criticism based on four major grounds:

(1) The economic analysis which is based on the same kind of thinking that has led many economists to support consumption taxation over income taxation was questioned in earlier ABA submissions.

(2) The incidence of a consumption style business level tax has not been spelt out in the literature. The impression is that it is intended to be on shareholders but it is difficult to see how that will be so if a destination base is used as proposed.

(3) The tax produces international double taxation to the extent that other countries continue to tax business on an income base, that is, it will only achieve the economic effects claimed if all major countries do it.

(4) The tax disadvantages produce countries like Australia as we would collect no tax from corporations on exports (such as mining and agriculture).

Discussion paper questions	ABA response/position
	interpretation and enforcement. This would clearly not be efficient as it would create duplication of work, differences and uncertainties over interpretation and not necessarily reduce the complexity for businesses or investors. A more effective longer term solution would therefore appear to be to eliminate the number of taxes (in particular the inefficient state duties) and simply increase the GST rate. This would reduce the number of taxes businesses would be required to manage, it would not increase the government enforcement requirements/costs (in fact it should reduce them), and could leverage off existing business systems and knowledge. In addition, it should not, of its own, result in any incentive for a business to move their business operations to an overseas jurisdiction.
(2) At the state level, are there opportunities for the States to rebalance their tax systems towards more efficient revenue bases?	A move away from State taxes on business produces measurable efficiency benefits, since it improves exports and investment. Efficiency gains can be of a similar order to other significant microeconomic reforms of the past. Harmonisation of the tax bases of a reduced number of taxes used by States will improve the operational efficiency of the State tax systems significantly. See (1)
Session 1: Personal tax	
(3) Are there ways to further reduce any disincentives to workforce participation?	See (13) below
(4) Are there opportunities to make policy changes to further simplify taxpayers' interactions with the personal tax system?	
(5) What is the best way for the personal tax system to be integrated with the business tax system in order to maintain the	

Discussion paper questions	ABA response/position
integrity and fairness of the overall system?	
(6) Does the tax system provide the right support to Australians who locate to the areas where their skills are most in demand?	ABA supports the recommendations of AFTS on the removal of stamp duties.
(7) Should consideration be given to moving towards a more neutral and consistent tax system for savings?	Further reform would assist with the rebalancing of Australia's disproportionate level of borrowing from overseas financial markets, which leaves all Australians at greater risk and more vulnerable to shocks to that market than would otherwise be the case and when compared with many of our regional trading partners.
(8) Are there opportunities to improve efficiency in the housing market with alternate tax settings and policies?	
(9) Are there opportunities to improve the rules for superannuation during the drawdown phase?	
(10) Are there unintended or inappropriate concessions in the tax system that could be removed to help fund priorities elsewhere? Are there better ways to structure and deliver concessions?	The research and development (R&D) concessions, as they currently exist and as proposed, are unnecessarily narrow and complex and do not compare favourably when considered against overseas comparisons. The compliance obligations in the rules make the application of the rules and any potential benefits difficult to predict with certainty and unnecessarily costly to implement and administer. The rules and the multiple government agencies responsible for enforcement, (i.e. the ATO and AusIndustry) are often focused on documentation and supporting paperwork that makes many smaller R&D activities (for both small and large businesses) even if it would be a legitimate claim for R&D, more marginal when considered in the light of the complexity, compliance costs and likely

Discussion paper questions	ABA response/position
	need for costly external advice and later time spent with these government bodies in audits. An industry has been created to support the compliance obligations, including the creation of various levels of documentation and supporting details for R&D claims. This effort could be better focused on the R&D itself. Some overseas governments pro-actively assist taxpayers with their R&D claims to both encourage R&D, provide certainty and to assist them making claims. This would be more appropriate for Australia, rather than relying on the compliance and enforcement agencies to promote R&D.
Session 2: Transfer payments	
(11) Are there ways to make the transfer system simpler for individuals and families?	See (3) above
(12) How should family payments and child care assistance support parents' choices about how to balance and share work and caring roles at different stages in their children's lives?	See (3) above
(13) What incentives and obligations in transfer payments could further encourage skills formation, workforce participation and promote early childhood development?	There is a need for Treasury to do some modelling on the wider impacts of the childcare rebate to determine what the impacts are on the wider economy over the working life of the parent. The banks have a large number of staff, particularly in branches, with children in childcare. Capping the childcare rebate will reduce the incentive for parents to return to work (i.e. reduce workforce participation) and may have an impact on their longer term prospects of returning to the workforce, particularly after a long absence. The individual's work skills and knowledge will not be utilised in the same way during that period of absence, and this may reduce their ability to return to work into a similar role at a later stage in

Discussion paper questions	ABA response/position
	their career. This in turn may affect their potential income and employment prospects more generally and will increase the likelihood of future skills shortages in the workforce, reducing Australia's productivity and income taxes collected by the government.
(14) How well do the characteristics of our income support system reflect current patterns of work life for Australians?	See (13)
(15) Does the current provision of public housing impact on workforce participation? If so, what incentives could be introduced to address this issue?	
(16) Are there unintended or inappropriate concessions in the transfer system that could be removed to help fund priorities elsewhere?	
Session 3: Business tax	
(17) What is the appropriate business tax system for Australia to maintain business tax revenue and economic growth?	The ABA considers that there should be no large-scale changes in the way that Australia levies tax, particularly with respect to businesses. Rather, as a mid-level economic power, Australia should determine its general direction for tax changes based on international consensus as reflected in country practice and international agreements, while ensuring that Australia remains an attractive destination for inbound investment and a significant base for outbound investment. Similarly, in keeping with current international trends, Australia should gradually reduce taxes on income from capital through targeted measures, and ensure that tax does not operate as a barrier to international transactions. This will become increasingly important to Australia and other countries over time.

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	Australia, as a mid level power, should not be leading the way in an untested cash flow tax and should instead leverage off an existing knowledge and the already implemented methods of taxation in the form of a GST. GST is one of the more efficient current taxes in Australia.
(18) Are there ways to reform the business tax system that can assist Australia to meet the challenges of mining boom mark II and make the most of the opportunities from the shift in global economic weight from West to East?	Implement the remaining recommendations of the Australian Financial Centre Forum: http://www.treasury.gov.au/afcf/content/final_report.asp.
	The proposed Controlled Foreign Corporation (CFC) changes, as released in the last Treasury consultation paper, are unnecessarily narrow and complex. They fail to take into account the change in the global market and reduce flexibility to the detriment of all Australians. Australian organisations are dealing more often with the growing Asian market. Our current taxation system, and the proposed changes in the CFC rules, penalise Australian businesses investing or expanding into these markets. The CFC rules penalise investments into jurisdictions which are not comparably taxed (i.e. non-listed countries) on the apparent assumption that all these investments are in some way driven by tax consideration, or that there will be some windfall gain. Given the current environment, the Asian market is likely to be Australia's future. The ability to source funding and deposits from Asia is problematic under the current CFC proposal. This is an inappropriate outcome given the difficulties in sourcing funding in many other markets. Flexibility for investment and funding is vital given the level of market globalisation.
	The general regulatory environment is not conducive to economic activity in Australia. For example, as a result of Basel III, some countries, including the UK, are considering whether to permit tax

Discussion paper questions	ABA response/position
	deductions for certain Tier 1 instruments. This is proactive strategic thinking that would promote those jurisdictions as a good place to invest, and would reduce the overall cost of funding for banks and ultimately businesses and consumers. A similar level of strategic thought and vision is needed in Australia to not only promote Australia but at a minimum to remain simply competitive. Without similar changes in Australia, Australian banks will not be competitive. The HMRC is working with industry to help draft amendments to tax law to allow 'any capital instrument' to be tax deductible, see: http://www.hmrc.gov.uk/basel3/index.htm. HMRC have also produced a discussion paper that outlines the concerns, they also have a working group that has been meeting regularly since mid May (http://www.hmrc.gov.uk/basel3/discussion.pdf): *"The tax treatment of these new instruments will be an important competitiveness issue for banks across the EU and beyond. In the midst of this changing regulatory landscape many banks and building societies are refinancing or considering future refinancing and they wish to do so in a way that is likely to conform to the expected future capital requirements.* *Tax will be an important consideration in the type and range of instruments that develop to meet the new regulatory requirements; however, a number of the required regulatory features of these instruments make the tax treatment under the present tax rules uncertain in a number of respects. In particular, while issuers of existing innovative tier 1 and tier 2 instruments in the form of debt generally enjoy tax deductions for any coupons paid to investors, instruments reflecting the loss absorbency requirement may not be tax deductible under current rules."*
(19) Should the company tax rate be lowered further, and if so, what other reforms within the business tax system might be used to fund this?	The Australian corporate tax rate should be reduced to 25% by 2017 and the rate would need to be periodically reviewed to judge whether it remains appropriate. This would be consistent with the policy approach in Australia in the last 20 years, and with the current environment, given the fact that many of our regional competitors are all operating in environments with rates that are lower than 25%.

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(20) Are there ways to further simplify business interactions with the tax system, especially for small business?	The process of drafting tax laws should be reformed, and a review board appointed to consider ways in which existing law can be made easier to use. In a self-assessment environment, it is important that tax laws are easily understood and applied, but the experience of the past 10 years has been that new law is often difficult to apply to relatively straightforward transactions.
(21) Should there be more symmetrical treatment of tax losses?	AFTS Recommendation 31 is supported. The ability to carry back losses would align Australia with one of our largest trading partners, the UK. It would also enable greater flexibility for businesses in times of stress and in financial crisis, without the need to increase debt funding to survive at a time when it is likely that sources of, and availability of, funding may be lower and the cost of funding may be higher.
(22) Should further consideration be given to potential longer term directions for the business tax system, such as deductions for equity financing?	Interest withholding tax (IWT) should be eliminated now on funding raised from non-residents, including offshore and onshore deposits, by Australian based financial institution groups. We note that this would not lead to any loss in revenue as the banks do not generally enter into funding arrangements where IWT is payable. Therefore removing IWT would open access to cheaper funding for banks, resulting in lower tax deductions and more money injected into the Australian economy. A number of offshore investment funds have mandates to make deposits directly with bank head offices rather than to offshore branches or subsidiaries. In Australia however these deposits are subject to withholding tax, hence the funds are deposited with non Australian banks. There are also investment funds with such large amounts to invest that it is not possible for offshore branches of Australian banks to accept the deposits. Additionally, a number of offshore jurisdictions require banks to hold liquid securities in-country to support local deposits. The removal of withholding tax on offshore customer deposits would be consistent with withholding tax not being applicable on term debt (eg bonds) issued to offshore investors.

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	Access to a larger pool of funds could be expected to enhance the ongoing management of liquidity risks and improve the cost of funds for Australian ADIs. This would be expected to contribute to the ongoing stability of the Australian banking system and produce benefits to customers of Australian ADIs such as more competitively priced products and services. This would be expected to generate increased tax revenues from additional bank earnings and possibly, from incremental customer earnings on new projects and investments.
	Simplify the tax law by removing unnecessary specific anti-avoidance provisions which create complexity and produce uncertainty, and ensure more consistent and balanced administration of the tax law.
	ABA recommends a board structure for the ATO with appointments from various groups including the private sector. In the ABA's view the similar experiment with the Board of Taxation in relation to tax policy has been a significant success and should be considered as a model for the ATO.
(23) Are there unintended or inappropriate concessions in the business tax system that could be removed to help fund priorities elsewhere?	See (10)
Session 4: State taxes	
(24) Does the tax system create disincentives for Australians to locate to the areas where their skills are most in demand?	The State tax regime should be streamlined by abolishing certain nuisance taxes, harmonising legislation and reforming Commonwealth/State fiscal relations – including the unification of revenue administration and collection.
(25) Are there opportunities for the States to replace stamp duties on property conveyances with reformed land taxes?	Replacement of stamp duties is supported. **Case study:** An member bank undertook analysis to determine how much credit is directed towards funding

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	stamp duty liabilities that arise from housing related borrowing What the case study specific analysis showed was that the average proportion of amounts borrowed by owner occupiers that related to stamp duty was 3.63%. For investment property loans, it was 5.11%. Extrapolated across the credit sector, using the RBA's D2 aggregate data, this would suggest that for owner occupier housing, of the $9.8B lent in 2010-11, $355M was borrowed to fund a stamp duty impost. For Investor housing, it would be have been $214M (of $4.2B lent). In total, for the one year period, private housing borrowers (on the sample data) required $569M in funding to meet the tax cost. The duty expense is a significant consumer of credit and adds to the indebtedness of the borrower. The 'lumpiness' of conveyance duty often means that housing participants have no choice but to borrow to fund the one off cost, increasing the interest burden at a time, it could be said, when it can be least afforded.
(26) Should States abolish insurance taxes? If so, how could that revenue be raised more efficiently?	Yes
(27) How might the reform or greater harmonisation of State payroll taxes be pursued?	
(28) Do GST sharing arrangements create the right incentives for States to make their tax bases more efficient?	ABA recommends the GST-free treatment of B2B financial supplies, or, the GST-free treatment of all financial supplies.
(29) Within our Federation, what responsibility	

Discussion paper questions	ABA response/position
should the States take for reforming the taxes they impose?	
Session 5: Environmental and social taxes	
(30) Should Australia consider ways to more closely link road charging to the impact users have on the condition and upkeep of roads?	
(31) Is there a case to more closely link road charging to the impact users have on the level of congestion on particular roads?	
(32) Are there aspects of other tax arrangements that create unintended incentives for adverse environmental outcomes, or ways in which governments could use specific taxes to ensure that people take appropriate account of environmental impacts in their decision making?	A tax incentive (such as increased tax write-off rates) for infrastructure would assist in the creation of more environmentally efficient power and transport, align with the government's current policy focus and help Australian businesses.
Session 6: Tax system governance	
(33) How might the greater use of technology and improved coordination and management of information be used to improve taxpayers' experience with the	

Discussion paper questions	ABA response/position
tax and transfer system?	
(34) What are the opportunities and challenges to further advance pre filling of tax returns?	
(35) Should the Government pursue the development of online tax and transfer client accounts?	
(36) Are there better ways that institutional arrangements for the tax system can be used to improve taxpayers' experience of the tax system?	Experience suggests principles based approach to design of the tax rules is not always accurate. For example, on many occasions decisions are made on the basis of revenue impacts first, rather than on the principle of whether the outcome is appropriate of fair.