June
2012

Business Tax Working Group

Consultation Guide

Reform directions for the business tax system

The Business Tax Working Group was established following the Tax Forum in October 2011 to consider what kind of business tax system will best support Australia's future growth prospects in an affordable way. The purpose of this consultation guide is to provide stakeholders with an understanding of how the Working Group plans to involve the community in its consideration of business tax reform.

This consultation guide

The Government has asked the Working Group to focus its attention on how a revenue neutral cut to the company tax rate might be funded from within the business tax system.

The Working Group looks forward to working with the community in developing its advice to the Treasurer and has released this consultation guide to set out its proposed approach to consultation over the next six months.

The Working Group has settled on a timetable for public consultation. The timetable sets out indicative timing only, to maintain some flexibility. Any updates to this timetable will be made available at www.treasury.gov.au/BTWG.

In addition to providing a timetable for consultation, this consultation guide sets out the principles that the Working Group will use to guide its thinking about the merits of particular base broadening options that could accompany a cut to the company tax rate.

The Working Group will provide a final report to the Treasurer setting out its views in December 2012.

Timetable for consultation

June 2012	**Consultation guide — released**
July 2012	**Discussion paper — released** The discussion paper is expected to be released in late July
August 2012	**Discussion paper — consultation** Consultation on the discussion paper will continue during August
September 2012	**Discussion paper — consultation** Submissions in response to the discussion paper are expected to close in early/mid-September
October 2012	**Draft final report** A draft of the final report is expected to be released in late October
November 2012	**Draft final report — consultation** Consultation on the draft final report will continue during November with submissions closing in late November
December 2012	**Final report** The Working Group is required to provide its final report to the Treasurer in December

Engaging the community in business tax reform

The Working Group's terms of reference require it to consult widely with industry and the broader community. In preparing its final report to the Treasurer on long-term business tax reform options, the Working Group intends to undertake two rounds of public consultation.

	Discussion paper	Draft final report
What is the consultation document expected to contain?	The discussion paper will focus on: • an overview of the potential benefits to the economy as a whole from business tax reform, focusing on a company tax rate cut; • a range of potential offsetting base broadening options that might contribute towards funding a cut to the company tax rate; • an assessment of potential reform packages (comprising different combinations of base broadening options and a cut to the company tax rate) against the principles for business tax reform adopted by the Working Group; • Treasury's revenue costings of potential reform packages; and • a discussion of potential tax design issues associated with particular reform packages, including the need for transitional rules.	The draft final report is expected to contain: • draft recommendations which reflect the Working Group's current thinking on potential savings options; • a summary of the key themes from consultation on the discussion paper; and • further information and analysis which have informed the Working Group's thinking so far, including potential impacts on national income and macroeconomic risks.
When is it likely to be released?	Late July 2012	Late October 2012
How long will stakeholders have to respond?	6-7 weeks	4-5 weeks
Will the Working Group be meeting with stakeholders?	The Working Group will endeavour to hold meetings with a range of stakeholders during this time.	The Working Group will endeavour to hold meetings with a range of stakeholders during this time.

Principles for business tax reform

Policies that remove impediments in the tax system to new investment will enhance productivity across the economy, supporting Australia's growth prospects and living standards. The Working Group's principles are intended as a framework for thinking about business tax reform in this context. Each principle is accompanied by explanatory text to guide its application.

The application of these principles will necessarily involve judgements about how a particular package of reforms performs against an individual principle and against the framework as a whole. In seeking to reform the tax system, principles can conflict and there will necessarily be trade-offs that need to be made in getting the balance right. A critical aspect of these trade-offs is that they be made transparently.

The terms of reference require the Working Group to have regard to the Australia's Future Tax System (AFTS) Review. In its final report to the Treasurer, the AFTS Review set out some core design principles for the tax-transfer system: equity; efficiency; simplicity; sustainability and policy consistency. Using these principles as a foundation, the Working Group has developed its principles for business tax reform.

1 **Revenue adequacy:** The business tax system should raise revenue that, together with other taxes, helps to pay for public services that the community relies upon.

The primary function of any tax system is to raise revenue to fund the provision of goods and services by the government. The Australian community will continue to demand efficient, responsive and relevant public services, funded by taxes.

Business tax revenues make a contribution towards funding these goods and services. This will continue to be the case, regardless of the particular reform options adopted.

The integrity of the system is important in securing predictable adequacy of revenue.

2 Economic efficiency: The business tax system should raise revenue in a way that minimises the effect of the tax system on business decisions except where this is needed to correct for market failures.

By distorting investment and production decisions, the business tax system can deter investment and lead to an inefficient allocation of resources within the economy. In this way, it can detract from Australia's productivity performance and future living standards.

Business tax should be applied in a way that minimises its impact on business decision making. It can be useful to think about the impact of business tax on the following set of decisions:

- What to invest in?
- Where to invest?
- How much to invest?
- How to finance investment?
- The organisational form through which to undertake the investment?
- Where to record profits arising from investment?
- How to distribute income?
- When to invest?

Efficiency gains arising from business tax reform will be realised as a result of changes in business decisions which in turn, over time, change prices and quantities. However, different tax reform proposals will affect these decision margins in different ways. All feasible options will retain some form of distortion, but the aggregate impact of some options will be smaller than others. Assessing these impacts is challenging, given the complexity of the overall tax system and the range of factors that influence business behaviour.

Efficiency enhancing reforms are more likely to be successfully implemented and sustainable if the rationale for change is clear and well understood by businesses and the public.

The tax system is one tool which the Government has at its disposal to correct for the failure of the market to take account of positive and negative spillovers or externalities. Tax concessions can be used to encourage socially beneficial activities in which there would otherwise be underinvestment. Similarly, tax can discourage activities that impose a cost on the community as a whole.

3 Distributional equity: The business tax system and potential reforms should be understood in terms of where the final incidence falls among capital owners, workers and consumers.

The size and openness of the Australian economy and the existence of economic rents suggest that in the long run most of the burden of Australia's company tax is probably borne by labour and consumers, but with some of the incidence falling on capital owners earning resource and other immobile rents.

In the short run, it is likely that a larger share of the incidence of a reduction in Australia's company tax rate (relative to rates applying elsewhere) would be captured by capital owners.

The company tax system raises revenue by acting as a final tax on foreign investors and, as a result of imputation, as a withholding tax on domestic investors. Proposed reforms need to be understood in terms of their impact on after-tax returns to different investors.

The interaction of business tax with elements of the broader tax-transfer system such as capital gains tax and personal income tax must be understood. Regard needs to be given to the distribution of share ownership among resident households and superannuation funds and non-residents and the different tax treatments of their income from companies.

4 Competitiveness: The business tax system should take into account Australia's integration with the global economy.

Australia has long been a net capital importing country, and will continue to be so, making it important that our business tax settings take into account the potential for the tax system to discourage investment by increasing the cost of foreign capital.

The growing importance of outbound investment means the competitive position of Australian business offshore is an important consideration for Australia's business tax policy.

The competitiveness of Australia's business tax arrangements also needs to be considered in the context of the range of other, non-tax factors that make Australia a good place to do business and invest.

5 Simplicity: Business tax reform should be aimed at making the system as simple and as easy to comply with as possible, having regard to an often complex business environment, the need to ensure the integrity of the system and the costs and benefits of transitioning to any new rules.

Businesses are more likely to make efficient decisions, and respond as intended to policy signals, if the business tax system is simple to understand and the processes necessary to comply are not unduly complex.

Simplicity can deliver productivity gains by allowing scarce resources to be reallocated away from tax compliance and administration.

However, the business tax system also needs to be able to cope with sophisticated business transactions and arrangements.

That said, complexity can undermine the integrity of the business tax system. The ongoing integrity of the business tax system is essential to its role in collecting revenue.

Complexity in the business tax system can also arise from interactions with other parts of the broader tax system.

Even where a particular reform may ultimately lead to a more efficient and less complex system in the long run, these gains should be assessed against the costs of transition in the short to medium term.

6 New investment focus: Business tax reform should generally focus on new investment.

Generally, business tax reforms are forward-looking. However, retrospective changes will sometimes be desirable. It is important that any reform proposals include a clear pathway from current arrangements to the desired reform destination. Transitional arrangements can also raise issues of fairness and system design.

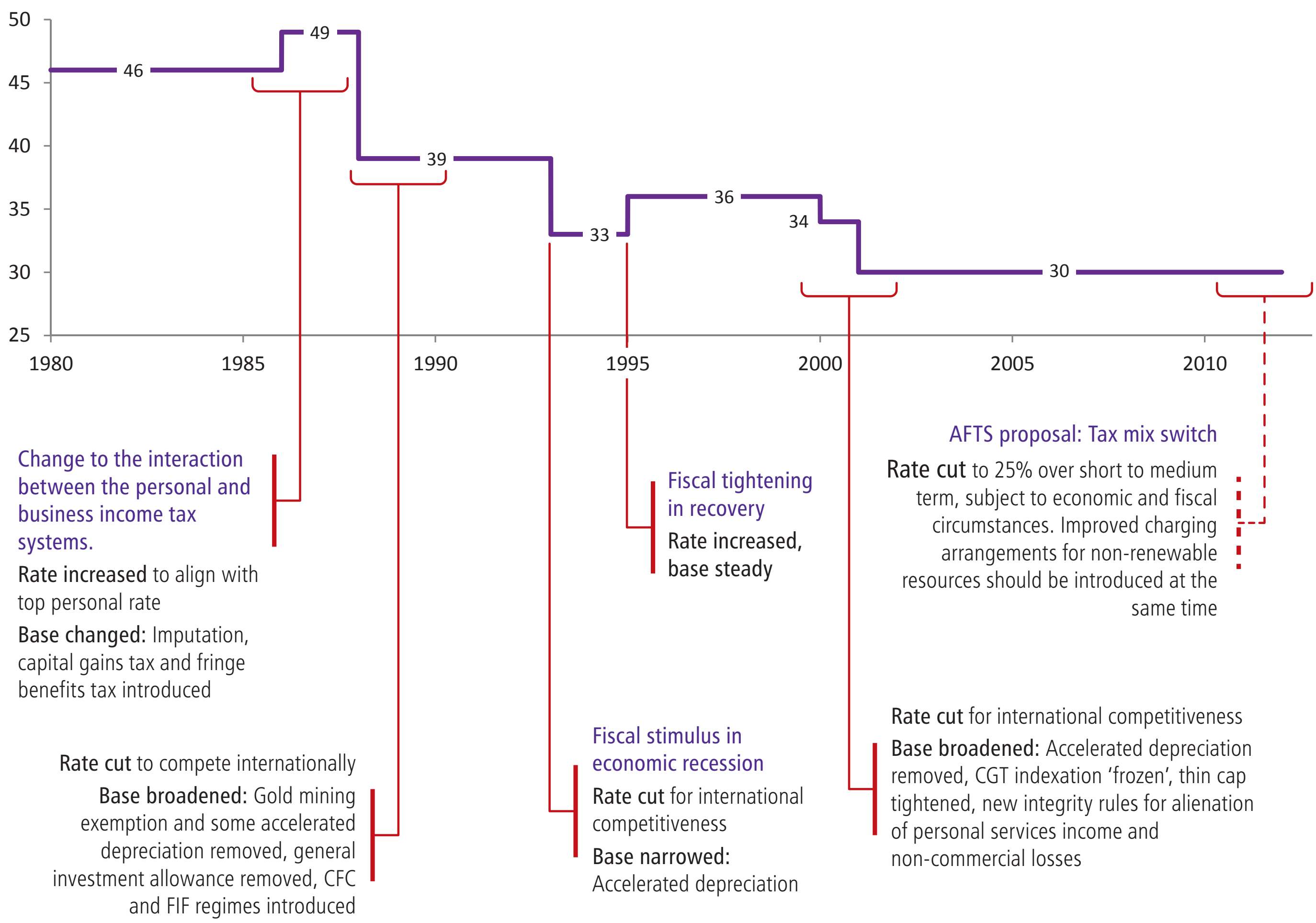
Changing the tax outcome of existing business ventures may deliver a windfall gain or loss to taxpayers. This needs to be weighed against any potential impact that tax reform may have on the revenue adequacy, efficiency and simplicity of the tax system.

Difficult decisions need to be made about the appropriate commencement of business tax reforms, taking account of the potential impacts resulting from these trade-offs.

The history of Australia's company tax rate

Australia's company tax rate has generally trended downwards since the 1980s. Where governments have increased the company tax rate it has been done to align it with the top personal rate or as part of a fiscal tightening. Significant cuts in the company tax rate have typically been accompanied by a broadening of the company tax base.

Figure 1: Company tax in Australia — the how and why of company tax rate changes (1980-2013)



Terms of reference

The Treasurer announced the terms of reference and the terms of appointment of the Working Group on 12 October 2011. The terms of reference set out the objectives of the Working Group as well as the scope of work and the timing of outputs. The Government has asked the Working Group to focus its attention on how a cut to the company tax rate might be funded from within the business tax system or business expenditure programs.

Objectives

1. The Working Group will make recommendations on how the Australian business tax system can be improved to make the most of the challenges and opportunities arising from transformations in the broader economic environment, including the patchwork economy.
2. The revenue neutral reforms to the business tax system will aim to increase productivity, while delivering tax relief to struggling businesses.

Scope

3. The Working Group will focus on reform options that relieve the taxation of new investment:
   - 3.1 in the near term, by reforming the tax treatment of business losses; and
   - 3.2 in the longer term, by reducing the corporate tax rate further or moving to a business expenditure tax system, particularly an allowance for corporate equity.
4. For its final reports, the Working Group will provide specific analysis of these business tax reform options, including:
   - 4.1 descriptions of how these reform options operate overseas and evidence on their effectiveness;
   - 4.2 potential priorities for reform, including transitional paths;
   - 4.3 worked examples of how these options would affect business taxpayers, including their financial and tax accounts;
   - 4.4 revenue integrity provisions, such as measures necessary to limit: the inappropriate claiming of tax losses; the equity allowance to new equity; and small and closely held businesses converting labour into business income;
   - 4.5 how the reform options integrate with the rest of the tax system now and in the future;
   - 4.6 impacts on national income and macroeconomic risks; and
   - 4.7 costings.
5. The Working Group will also identify a range of off-setting budget savings from existing Commonwealth business taxation (or spending) measures. Changes to the GST should not be considered.
   - 5.1 The savings to be generated by the particular options will be costed by the Treasury in accordance with the budget rules.
6. In developing its recommendations, the Working Group should have regard to the report of the Australia's Future Tax System Review and relevant international experience and expertise.

Timing

7. The Working Group is required to provide the Treasurer with:
   - 7.1 an initial report on the proposed directions for improving the tax treatment of losses and offsetting savings in mid-November 2011;
   - 7.2 a final report on the treatment of losses and the offsetting savings in March 2012; and
   - 7.3 a further report on longer-term business tax reform options and offsetting savings by the end of 2012.

Consultation

8. For its final reports, the Working Group should consult widely with industry and the broader community.
9. The Working Group may establish technical sub-groups to consider specific issues or seek input from other sources of expert advice.

Support

10. The Working Group will be supported by a Secretariat within Treasury.

Government priorities

The Government has indicated through the Prime Minister's explicit statement at the economic forum that the Working Group's immediate attention should be focussed on finding savings to fund a cut in the company income tax rate.

Membership and contact information

The Working Group was established as one of the initiatives to come out of the Tax Forum in October 2011. The Working Group includes representatives from the business community, unions, the tax advisory profession and academia.

Information about the Working Group, including previous reports and information about current consultations can be found at: www.treasury.gov.au/BTWG.

Chris Jordan — Chair

Chris Jordan is a Fellow of the Institute of Chartered Accountants, the Taxation Institute in Australia, and the Australian Institute of Company Directors and is a Solicitor of the Supreme Court of New South Wales.

He is the Chairman of the Board of Taxation which is an advisory body to the Federal Treasurer and is a board member of the Sydney Children's Hospital Foundation and the Bell Shakespeare Company.

Chris was awarded the honour of Officer of the Order of Australia in the 2005 Queens Birthday Honours list for high-level advice to Government.

Jennifer Westacott

Jennifer Westacott took up the role of Chief Executive at the Business Council of Australia (BCA) in April 2011.

Jennifer has extensive policy experience in both the public and private sectors. She has held critical leadership positions as the Director of Housing and the Secretary of Education in Victoria, and most recently was the Director-General of the New South Wales Department of Infrastructure, Planning and Natural Resources.

Jennifer was a Director and National Lead Partner at KPMG and provided advice and assistance to some of Australia's major corporations on climate change and sustainability matters, and provided advice to governments around Australia on major reform priorities. She previously chaired the Public Sector Performance Commission in South Australia, and was a member of the Commonwealth Grants Commission.

Teresa Dyson

Teresa Dyson is a Tax Partner in Ashurst's Brisbane office, specialising in providing income tax advice on corporate and financing issues to domestic and international businesses. Teresa is a member of the Board of Taxation and the Resource Taxes Implementation Group.

Teresa is the National Chairman of the Law Council of Australia, Business Law Section, Tax Committee and, in that capacity, represented the Law Council of Australia at the Tax Forum. She is currently recognised as a leading individual in tax in Chambers Global 2012 and Best Lawyers 2012.

Frank Drenth

Frank Drenth has been in the role of Executive Director of the Corporate Tax Association (CTA), since 1998. The CTA represents the taxation interests of about 120 of Australia's largest companies. He is also Deputy Chair of the Business Coalition for Tax Reform, which brings together the views of the broader business community on tax reform issues.

Over a period of many years Frank has had extensive experience as an external stakeholder in the development of Australia's tax policy and law, as well as aspects of tax administration that are relevant to large companies. Frank has previously occupied corporate tax roles in large Australian companies. He has also worked a large chartered accounting firm after starting his career with the Australian Taxation Office.

Tim Lyons

Tim was elected as Assistant Secretary of the Australian Council of Trade Unions (ACTU) in August 2008. Prior to that, he was an official of the National Union of Workers (NUW) for over 13 years, and represented members in a wide range of industries, including logistics, food, plastics, oil and gas and general manufacturing.

Tim is also a member of a range of government committees, including in relation to superannuation, workplace relations and procurement. Tim is a Trustee Director of HESTA superannuation fund, a director of The Union Education Foundation and the Australian representative on the Global Unions Committee on Workers' Capital.

His work as an industrial officer and advocate focused on bargaining and industrial action, including in appellate and test case proceedings, particularly the low-paid.

Rob McLeod

Rob was appointed Ernst & Young's Oceania Managing Partner and CEO in 2010 and was previously Ernst & Young's New Zealand Country Managing Partner. He has more than 30 years experience in corporate and international tax.

Rob has held a number of high profile roles in New Zealand including Chairman of the New Zealand Business Roundtable. In 2001, he conducted the most recent comprehensive New Zealand government tax review — the McLeod Review. In 2009, he was appointed to the government-sponsored Tax Working Group and the Capital Markets Development Taskforce, both of which had a strong focus on tax reform. He was also a member of the New Zealand Government appointed Consultative Committee on Capital Gains Tax in 1989.

He has been appointed to numerous government committees, the latest ones focusing on defence, infrastructure and Maori economic development.

Peter Burn

Dr Peter Burn, Director of Public Policy, Australian Industry Group (Ai Group), has extensive experience in taxation policy through his role at Ai Group since 2002 and as Director — Policy at the Business Council of Australia with particular responsibilities for taxation policy from 1997. Peter was also the Secretary of the Business Coalition for Tax Reform in the years around the Australia's New Tax System.

Prior to these roles, Peter lectured in public finance and microeconomic policy at the University of Queensland and the University of Newcastle and still earlier served in the Tax Policy Division of Treasury during the 1980s reforms to Australia's tax system.

Rob Heferen

Rob Heferen is the Executive Director of Treasury's Revenue Group which is responsible for providing advice and assisting in the formulation and implementation of government taxation and retirement income policies and legislation as well as providing information on material changes to taxation revenue forecasts and projections.

John Freebairn

John Freebairn holds the Ritchie chair in economics at the University of Melbourne. He has degrees from the University of New England and the University of California, Davis. Prior to joining Melbourne in 1996, his preceding career includes university appointments at the ANU, LaTrobe and Monash, and periods with the NSW Department of Agriculture and at the Business Council of Australia. John is an applied microeconomist and economic policy analyst with current interests in taxation reform and environmental economics.

Contact information

The Working Group is supported by a secretariat based in the Treasury.

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