



**CORPORATE TAX
ASSOCIATION**
of Australia Incorporated

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

RE:THINK TAX DISCUSSION PAPER

The Corporate Tax Association (**CTA**), which represents the taxation interests of 110 of Australia's largest companies, welcomes this opportunity to comment on the Government's Re:think Tax Discussion Paper (**Discussion Paper**), the Government's first step towards its commitment to produce a comprehensive White Paper on tax reform.

The CTA strongly supports the Government in its pursuit of tax reform. In our view, the pursuit of effective tax reform must encompass the following:

- A continuing commitment from the Government to sell the drivers and benefits of tax reform to the community.
- A genuine and inclusive debate on community aspirations with a focus on the future sustainability of current arrangements.
- Engagement on all aspects of the tax system, including those areas that traditionally engender the most debate and disagreement.
- A willingness to address the challenges facing our tax system, which include:
 - o Decreasing our current corporate tax rate and addressing bracket creep.
 - o Reassessing our tax mix so that our revenue base is more reliant on stable and less distortive sources of revenue.
 - o Actively participating in the global search for solutions to what are global tax problems.
- Developing and maintaining a competitive tax system that encourages productivity and growth and generates sustainable levels of taxation revenue for the benefit of all Australians.
- Eliminating the most economically inefficient taxes from our tax system.
- Stopping the cycle of complexity in our tax system.
- Reducing the cost of compliance

- Addressing the structural deficiencies in our tax governance framework to enable the development of a tax system that is responsive rather than reactive.

The CTA is committed to assisting the Government in achieving its goal of a better tax system for all Australians. We look forward to participating in what we hope will be an all-encompassing national conversation around tax reform.

If you have any questions on any aspect of our submission, please feel free to contact me or Paul Supree on (03) 9600 4411.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Michelle DeNiese', followed by a period.

Michelle DeNiese
Executive Director
Corporate Tax Association

CONTENTS

EXECUTIVE SUMMARY	4
CHAPTER 1 - CHALLENGES FOR AUSTRALIA'S TAX SYSTEM.....	8
CHAPTER 3 – INDIVIDUALS	10
CHAPTER 5 - GENERAL BUSINESS TAX ISSUES	11
CHAPTER 8 – THE GST AND STATE TAXES	15
CHAPTER 10 – COMPLEXITY AND ADMINISTRATION	16
CHAPTER 11 – TAX SYSTEM GOVERNANCE.....	19

EXECUTIVE SUMMARY

In our view, the primary objective of the Discussion Paper is to stimulate a national conversation about tax reform. To assist in this process, we provide the following comments which address the key points raised in the Executive Summary of the Discussion Paper.

The time for a national conversation around tax reform is now

The tone and scope of the Discussion Paper confirms the Government's commitment to a national conversation around tax reform. Such conversations are inherently difficult and require courage and commitment from the Government pursuing them. To this end, we commend the Government's approach to the conversation in the Discussion Paper and encourage all stakeholders to approach this process with an understanding of the urgency in which this conversation must take place. Business as usual is not an option.

An important aspect of the national conversation is the Government's role in continuing to sell the drivers and benefits behind tax reform to the broader community. Understanding and agreement on the need for tax reform is crucial to engendering trust in the process which in turn will form the basis of a package of reforms being widely accepted. Acceptance will only come if the Government constantly reinforces the case for tax reform through its words and (more importantly) its actions.

Selective participation and the narrowing of the focus of the debate must be avoided. An open minded and participatory process, incorporating genuine debate on community aspirations and how these could best be funded, can only be done if all aspects of the system are on the table. Although we recognise the difficulties associated with the current political environment, every effort must be made to focus on the benefits of tax reform for all Australians, rather than on populist handouts. Avoiding those issues that are considered to be in the 'too hard basket' will only serve to further disassociate the public from the conversation we all need to have on tax reform.

Finally, it is important to recognize from the outset that well considered and designed tax reform should not be a zero sum game. Rather than simply cutting rates or stepping out thresholds for the sake of it, we should be focusing on tax changes that have a positive impact on behaviours that promote investment, participation rates, innovation and international competitiveness. That is the essential difference between tax change and tax reform.

We need to keep the economy growing to safeguard our way of life

Australia currently faces some significant challenges which, if left unchecked, will have

an adverse impact on the very high living standards we enjoy today. The most immediate challenges facing our economy are well known - an ageing population and the need to lift workforce participation rates, falling terms of trade and the transition from mining investment to broader based drivers of growth, and our increasing infrastructure deficit.

These challenges, when viewed in the context of increasing spending pressures and declining revenue bases, place Australia on a dangerous path if not addressed. Comprehensive tax reform is one of the ways in which these challenges can be addressed. Aside from revenue collections, the other element to Budget outcomes is Government spend, and we highlight the need for Government to efficiently address its outlays as the other means to manage Budget deficits in the medium to long term.

Our tax system needs to support the modern economy

The economic environment in which our tax system operates has changed dramatically over the past 50 years. Over that period, Australia's overall tax mix has been weighted in favour of corporate and personal income taxes. Policy changes over that time have not materially altered the overall mix of income tax compared to indirect tax, despite significant changes in the global economy which have resulted in the flow of financial capital and labor becoming increasingly sensitive to Australia's tax settings.

To this end, we strongly support the following observations made in the Discussion Paper:

- Corporate tax rates that are increasingly uncompetitive will make it harder for Australia to continue to attract necessary investment. We note the unweighted OECD average corporate tax rate is now at 25%, reducing from 27.7% since 2006, compared to the Australian corporate income tax rate of 30%.¹ Similarly the effective tax rate on foreign income is high, given foreign profits are taxed in the home jurisdiction and effectively taxed again in Australia when distributed to Australian shareholders as a dividend without the benefit of credits for foreign taxes paid.
- Bracket creep and higher personal income taxes can reduce participation incentives for some people. Over time, unchecked bracket creep could potentially reduce workforce participation and the opportunities afforded to the community by higher participation rates.

This is where a review of our current tax mix necessarily enters the debate.

¹ The global average corporate tax rate is now 23.6%, reducing from an average of 27.5% in 2006

The Government's review of roles and responsibilities across the Federation provides a once in a lifetime opportunity to examine the whole of the tax system

Australia's tax and transfer system, with its many Federal-State interactions, should support Australia's growth and prosperity. The inefficiencies that have manifested as a result of the divide between State and Federal roles and responsibilities cannot and should not be underestimated. If we are to embark on meaningful tax reform these inefficiencies must be considered and addressed.

The tax system raises the revenue required to fund public services

The proper consideration of tax reform options presumes a view, however imprecise, about whether relatively more or less revenue is likely to be required over the years ahead to assist Governments to meet their responsibilities. Such a view is best determined by pragmatically assessing the size and urgency of gaps between reasonable community expectations and the Government's ability to deliver on those expectations.

The findings from both the Commission of Audit and the Intergenerational Report confirm that we have an immediate tax issue in Australia – the tax system in its current form is simply incapable of raising the revenue required to fund the public services Australians want and expect in the future. It is the responsibility of those that lead or seek to lead our country to accept this fact and in doing so, address public expectations around what services can realistically be provided on a sustainable basis whilst supporting a productive and competitive tax system that raises the revenue required to fund public services whilst also supporting the most vulnerable and needy within our society into the future. This requires a strong and vigilant focus on prudent and appropriately targeted Government spending, as well as the implementation of an effective tax system.

There is evidence that the economic costs of revenue raising in Australia are higher than they need to be

Our system relies predominantly on taxes that impose high economic costs. OECD and Treasury research over recent years have pointed to corporate taxes as the most harmful for growth, followed by personal income taxes.

Relying too heavily on taxes that impose the highest economic costs places a natural impediment on Australia's productivity. This is an important point that must be communicated to the public effectively and consistently.

There are opportunities to simplify the tax system

Australia's overly complex tax system goes well beyond what is required in terms of

certainty and risk minimisation. In fact, the sheer complexity of our income tax system and associated tax laws, which now stretches over four volumes, has had the perverse effect of increasing the risks associated with complying with the system rather than eliminating them.

Not enough attention is paid to the staggering cost of compliance with the tax system which is estimated at approximately \$40 billion a year. All stakeholders must take some responsibility for this – overly risk averse attitudes from policy advisers combined with an insistence on certainty from taxpayers has led to a system that is virtually incomprehensible in parts. Our disproportionate reliance on corporate and personal income taxes has also resulted in a perceived need for multiple and sometimes overlapping tax integrity measures.

There are real and substantive opportunities to address this issue. Some obvious examples are reducing complexity in the fringe benefits tax and harmonisation of the various State and Federal taxes imposed on similar tax bases. The recent announcement of the introduction of a statutory discretion to allow the Commissioner of Taxation to modify the operation of the tax and superannuation law to ensure the law can be administered to achieve its purpose or object is a step in the right direction in reducing complexity for taxpayers under the current system. It is not, however a sustainable model. The development of safe harbours, which strike the right balance between revenue protection and taxpayer certainty, is another effective way in which some of the sting of complexity can be taken out of the tax system.

There are opportunities to improve the fairness of the tax system

There has been much debate around the justification of tax concessions within our system and the need for these concessions to be appropriately targeted. What appears to be missing from these discussions is an agreed understanding on what it is that the various concessions which are offered under our tax system are designed to achieve.

Having a clearer understanding (or even better, consensus) on the policy intent and long term sustainability of various concessions would allow for a more mature and productive debate around how they might be structured. To this end, we consider the tax reform process to be an ideal opportunity for Treasury to better articulate the policy intention of the more contentious areas of the tax system.

Although we don't adhere to the use of the term 'fair' in the context of the tax system (on the basis that it is a subjective term), it is true to say that we cannot embark on a 'fair' tax reform process if some reform options are taken off the table. Most, if not all reform inevitably involves adverse outcomes for those impacted. Therefore excluding any reform options will invite accusations of unfairness and will necessarily tar any outcomes of the reform process with the same brush.

A final comment on the concept of 'fairness' - assessments of whether the tax system is fair cannot be made in isolation. True tax reform has many moving parts, and those

parts must be considered as a whole before making any determinations about whether a system is effectively delivering services to those who most need them whilst ensuring those who are contributing to the system are contributing the correct amount. The tax system should be economically efficient and stable. Debates around fairness are more appropriate in the context of the transfer system and how it interacts with the tax system.

The tax treatment of savings is very complex and distorts savings choices

The tax treatment of savings is an emotive topic as it touches virtually all Australians. An immediate consequence of this sensitivity is that it is the area most likely to suffer from political pressure.

What is indisputable is that the current tax treatment of savings needs to be considered in the context of what is sustainable in the medium to long term. This should include consideration of all options, with nothing left off the table. To carve areas out of the tax reform process will only serve to further deepen divides around how our system is perceived and will significantly undermine any tax reform process. Ruling significant parts of our system out of the process will also result in others asking for the same treatment which will inevitably result in there being very little left to reform.

Transitional arrangements are important

Comprehensive tax reform necessarily occurs over a period of time. Adequate care and consideration needs to be given to how we achieve our long term objectives within the confines of existing policy, under which taxpayers may have made long term decisions.

Adequate transitional arrangements however should not be devised with too close a focus on the fairness of each individual element of a reform package – the focus needs to be on whether the complete reform package delivers equitable outcomes, which will require everyone to see the forest for the trees.

We now turn to some specific questions posed in the Discussion Paper.

CHAPTER 1 - CHALLENGES FOR AUSTRALIA'S TAX SYSTEM

Question 1: Can we address the challenges that our tax system faces by refining our current tax system?

The CTA believes that Australia's current tax system can address the major challenges facing Australia by addressing some of the deficiencies in our current tax system. This includes:

- Addressing the current corporate tax rate and bracket creep.

- Reassessing our tax mix so that our revenue base is more reliant on stable and less distortive sources of revenue.
- Actively participating in the global search for solutions to what are global tax problems.

Addressing the current corporate tax rate and bracket creep

With the global mobility of people, capital and business investment, Australia's business tax system must be internationally competitive to encourage businesses to invest in Australia. Businesses globally are looking to streamline their processes and functions and exhaustively confirm that all aspects of their affairs are at maximum competitiveness, including their supply chains, their international locations and their tax efficiency and risk management.

Tax competitiveness is a dynamic process and, notwithstanding major and valuable Australian tax reforms in the 1980s, 1990s and (to a limited degree) more recently, other countries have also reformed their tax systems to attract globally mobile investment and talented people, with a focus on reducing income tax rates. For example, in 2005 Britain, Canada, New Zealand, Germany, Italy and Turkey all had company tax rates above 30%. Now the average rate between these countries is 22.5%.

Australia is now in the position of having one of the highest corporate tax rates in the OECD and individuals earning over \$80,000 per year will soon be paying tax at 37%, our second highest tax bracket, as a result of bracket creep. If Australia wants to be an internationally competitive nation which attracts and retains investment and people, the current company tax rate needs to be lowered and bracket creep must be addressed.

Reassessing our tax mix so that our revenue base is more reliant on stable and less distortive sources of revenue

As noted above, corporate taxes are regarded as the most harmful for growth, followed by personal income taxes. Moving the revenue base from income taxes to less distortive taxes such as taxes on things like consumption would provide a more stable and less distortive base for our tax system.

Australia's heavy reliance on income taxes also acts as a driver for complexity and places revenue collections at the mercy of external forces that are beyond our control. The recent drop in commodity prices and the consequential impact on corporate income tax collections is a current and powerful example of this. This reliance is even more concerning when you view it in the context of a comparably high corporate tax rate.

We need a system that is built on taxes that encourages economic growth and opportunity. To rely so heavily on the volatile proceeds of company tax and bracket creep, rather than address the structural problems underpinning the system, is simply unsustainable.

In making these points, we recognise that addressing the current corporate and individual income tax rates will come at a cost, and that any changes to the GST would necessarily be accompanied by targeted compensation. Addressing concerns around the effectiveness and long term commitment to any compensation arrangements will be vital in terms of public acceptance of such a large scale change to our tax system. However, as stated earlier, the immediate outcomes of such changes should not be viewed through the optics of a change to the tax mix alone. The medium to long term benefits of such changes, although difficult to sell in a three year electoral cycle, are significant and must form the basis of any discussions of why these changes are needed.

Actively participating in the global search for solutions to what are global tax problems

Globalisation, whilst providing real opportunities for our future, has given rise to some difficult and challenging issues, as canvassed in the Discussion Paper.

At the heart of all the problems associated with the interaction of globalisation and global tax systems is the fact that the concepts underpinning our international tax framework were built in a 'bricks and mortar' era. As such, there are a number of areas where the tax legal framework has not kept pace with the way modern business is conducted. These issues have been under serious scrutiny by the OECD under its Base Erosion and Profit Shifting (**BEPS**) Project since early last year and supported by the G20 at a political level.

The CTA supports the OECD BEPS project and commends the Government on its leading role in the G20 and its ongoing engagement in the OECD process. As stated in the Discussion Paper, Australia's objective in engaging in these processes is to assist in reshaping **global** rules to ensure confidence in the tax system and better counter inappropriate multinational tax planning (emphasis added). The problems now associated with BEPS are global problems, and global problems necessarily require global solutions. Continual and active engagement in these international processes is the best way to address the challenges posed by globalisation on Australia's tax system. In this regard Australia should avoid any further unilateral action in advance of BEPS outcomes.

CHAPTER 3 – INDIVIDUALS

Question 6 – Individuals Tax System

The employee share (ESS) scheme tax rules are an important part of the Australian individual tax system. Despite a number of relatively recent reviews of the regime, the rules for most employees remain overly complex and include many taxing points, tax collection issues and uncertainties, which result in significant tax support required by employers.

The most concerning aspect of the ESS rules is the taxing point when an employee

ceases employment. This taxing point is contrary to the objective of aligning the taxing point with when an employee can realise value from the ESS award. Australia remains out of alignment with most countries in its approach to taxing equity awards when an employee ceases employment. There are significant adverse consequences to individuals as a result of having to fund tax liabilities in respect of benefits they have not yet received and may never receive.

In our view, the ESS rules should be redesigned with the objective of streamlining compliance and improving exemptions so that they operate to encourage employee share participation for the Australian workforce. Any effective review of the ESS rules should address the issue canvassed above and align the taxing point with when the individual realises value from the ESS award.

QUESTION 7 – FRINGE BENEFITS TAX

Since its introduction in 1986, the FBT system has become progressively more complex and inefficient in terms of compliance, inconsistent policies and exemptions. For many businesses, FBT requires more compliance processes, form-filling and documentation than does income tax.

The complexity and compliance costs associated with the FBT regime are completely unjustified in terms of the revenue it raises. A major strategic review of the FBT should be undertaken as part of this tax reform process. All fringe benefit tax (FBT) exemptions should be reviewed to determine their continuing appropriateness. To improve simplicity, consideration should also be given to excluding fringe benefits from tax where the costs of compliance outweigh equity and tax integrity considerations.²

The CTA will be providing further information on the actual cost of compliance with the FBT regime in the coming months to assist the Government in implementing a more efficient and better targeted FBT system (see further comments under Chapter 10, Complexity and Administration).

CHAPTER 5 - GENERAL BUSINESS TAX ISSUES

Given our ongoing engagement in the tax reform process through the Board of Taxation, Treasury's Tax White Paper Taskforce and the Tax White Paper Unit, we have limited our response to some general observations around Australia's business tax system. The CTA and its members will provide feedback on the more specific aspects of the business tax system throughout the course of the consultation process.

These observations are made in the spirit of participating in a national conversation around what the best business tax system for Australia might look like. We

² Australia's Future Tax System December 2009 – Recommendation 9

understand and accept that reform of all aspects of the business tax system is not feasible in the short term. But perhaps over a longer period, these issues can be considered and acted upon, with the view to implementing a business tax system that encourages productivity and economic growth and generates sustainable levels of taxation revenue for all Australians.

Question 24 - An internationally competitive, lower corporate tax rate

- As an importer of capital, Australia's current corporate income tax rate is too high and is placing Australia at a competitive disadvantage. Although we recognise that it is not feasible for Australia to match the very low tax rates of some of our Asian neighbours, the ever increasing margin between our corporate tax rate and our competitors does not bode well for Australia in terms of attracting foreign investment.
- The primary driver of a foreign investment decision is the after tax return (whether measured in terms of NPV of cash-flows, rate of return, or earnings). The corporate tax rate is obviously an important component in calculating after tax returns. Australia needs to have a corporate tax rate that is competitive with its major trading partners. The current rate clearly sits outside what could be considered the competitive range. Supporting a gradual reduction over the medium term of the corporate tax rate to 25% would bring Australia back within that range.
- The benefits of cutting the corporate tax rate have traditionally been overshadowed by the misconception that the burden of corporate tax falls on 'someone else'. That 'someone else' is actually the Australian public, which suffers the burden of a high corporate tax rate through higher prices, lower wages and smaller dividends.
- A number of influential studies, including one most recently undertaken by Treasury, indicate that in the long run, much of the burden of company tax falls on Australian workers, via lower amounts of capital investment in Australia which in turn reduces the output or productivity of labor.

Question 25 - Ensuring the dividend imputation system supports Australia's open economy

- The dividend imputation system is an integral element of Australia's stock market capitalisation of major Australian listed companies and the taxation of superannuation funds for Australia.
- Australian companies are very attuned to the preferences of local investors for fully franked dividends and the fact that minimising tax on Australian sourced profits (and thereby reducing their ability to pay franked dividends) is a zero sum game. In other words, the imputation system acts as a natural deterrent to avoiding Australian tax.

- The systematic elimination of dividend withholding tax on the distribution of foreign profits by Australian companies to foreign shareholders has meant that the dividend imputation system delivers limited benefits to many foreign investors.
- The imputation system also does not address economic disparities between dividends received by Australian company shareholders from foreign profits, which are effectively taxed at a 30% higher rate than domestic profits.
- The impediments imposed by the imputation system on foreign investment were looked at in some detail by the Board of Taxation in 2003 in its report into Australia's international tax arrangements. Providing partial imputation benefits (either in relation to foreign sourced income or across all dividend income) and the allowance of some dividend streaming mechanisms were the primary options proposed.
- These options should be considered in the context of ensuring that the imputation system effectively supports foreign investment in Australia and Australian investment overseas. Serious consideration of these options would also enable these issues to be addressed within the existing framework of the imputation system which has, since its introduction, provided a significant incentive to invest in Australian companies and has enhanced capital formation and savings in Australia.

Question 27 - An internationally competitive tax system for capital investment in Australia

- The tax treatment of capital assets influences investment decisions in Australia.
- Australia's growth requires business capital investment to supplement Australia's workforce and natural resources, to enhance productivity and prosperity. Unfortunately Australia's tax capital allowances for plant and equipment do not make Australia an internationally competitive location from a tax perspective in which to make capital investments.
- Consideration should be given to replacing Australia's effective life regime with an internationally competitive capital allowance scheme with "broadbanding" rules and attractive capital allowances rates. Investment allowances should continue to be used where investment stimulus is required.
- In making this suggestion we note that most of the changes to Australia's capital allowance rules have been made through the lens of revenue neutrality. Although we understand the political and revenue pressure associated with pursuing an internationally competitive business tax system, it should be recognised that such a system, particularly one which is heavily reliant on capital intensive industries, would necessarily have a competitive tax regime for capital

investment.

Question 29 - Tax loss rules that are competitive and encourage innovation and business restructuring

- Australia's rules in relation to tax losses are too restrictive and not internationally competitive. This is particularly relevant at a time of uncertain economic and financial conditions when businesses may be looking at volatile trading and tax outcomes and potential ownership changes; and are conscious of the international comparatives when assessing where to locate their functions and investments.
- A sizeable proportion of Australia's tax loss rules were introduced prior to the tax consolidation regime and therefore deal with non-existent problems. Nevertheless, these rules need to be considered during any corporate restructure and can impede potential efficiency driven restructures.
- Other countries have more generous rules in relation to tax losses than Australia. Such rules include the ability to carry losses back as well as forward.
- A review of Australia's tax loss rules (in particular the Same Business Test), their interaction with other tax regimes (including tax consolidation) and the quarantining of losses incurred on capital assets is long overdue. Consistency between (or alignment of) the trust loss rules and the company tax loss rules should also be considered as part of this review.

Question 30 - Improving the tax treatment of intangible assets

- Changes in the global economy have given rise to a dramatic elevation in investment in intangible assets. To this end, we note the statistic provided at page 9 of the Discussion Paper – that investment in assets such as trademarks, patents, copyrights, goodwill and branding has been growing at around 1.3 times the rate of tangibles for the past 40 years.
- Unlike many other countries, Australia still does not allow tax amortisation of business intangible assets, such as acquired goodwill, special processes, systems, and techniques not being copyrights or patents. This places Australian businesses at a competitive disadvantage in business acquisitions. An acquirer of a business receives tax amortisation only for tangible assets such as physical plant and equipment and a narrow range of intangible assets, but with no recognition for intangible assets such as specialist processes or knowledge which have significant commercial value.
- It is also worth noting that the current treatment of some assets under the capital allowances regime is completely out of step with the pace of development of intellectual property, the most obvious examples being the treatment of copyright (25 years) and in-house software (5 years). For example, the current rules create a disincentive for Australian software development

where the particular software does not qualify for the R&D concession and where the software is licensed to third parties. Where this is the case the relevant developer is not entitled to depreciate software under the 5 year 'in house' regime and must depreciate the software over 25 years. This makes little sense in economic terms as most software is obsolete within 3 years. Aligning Australia with other jurisdictions on the treatment of integral business assets such as in-house software should be looked at in the context of improving the tax treatment of intangibles.

- In an environment where intangible assets are as important as tangible assets for many businesses, this tax treatment makes Australian business less competitive than companies from the United States, United Kingdom, Germany, Netherlands, Indonesia and others, which recognise the value of intangible assets and so offer such capital allowances, when they are bidding to acquire companies rich in intangible assets. This is particularly relevant as the vendor is generally taxed on the full proceeds received, but the purchaser is denied a tax deduction for acquired goodwill. In other words, this treatment disadvantages Australian entities in competitive takeover situations where they are competing with bidders based in jurisdictions that provide taxation depreciation for acquired goodwill.

Question 34 - Ensuring competitive tax rules for international transactions

- The CTA strongly supports the modernisation of the international tax system to ensure consensus on when and where companies that operate in multiple jurisdictions pay tax.
- When reviewing the work and early recommendations of the OECD BEPS Action Plan, it is clear that Australia has some of the most robust and stringent transfer pricing (and supporting anti-avoidance) rules in the world.
- To ensure tax avoidance practices are appropriately addressed, care must be taken not to overstep the multilateral process being undertaken by the OECD. To continue to be aligned with the OECD recommendations around transfer pricing is the most effective way to avoid excessive regulatory burden and to encourage investment.

CHAPTER 8 – THE GST AND STATE TAXES

Question 52 – an opportunity to reform State taxes

It has long been recognised in Australia that whilst tax revenue is drawn from more than 100 different taxes, the lion's share is collected from just a few. The Henry Tax Review stated that around 90 per cent of Australian tax revenue is raised through only 10 out of some 125 different taxes that are currently levied on businesses and individuals. Adding further complexity to the number of taxes being imposed is the fact

that they operate on a stand-alone basis, with different thresholds and rates being offered across States.

For example, if an Australian business operates in every State and Territory, it must deal with up to eight different State and Territory payroll tax Acts, eight different conveyance duty (stamp duty) Acts, eight different insurance, fire service levies, and other tax Acts, all of which are administered by eight different revenue authorities.

Whenever an Australian business considers a business reorganisation within Australia to improve efficiency, or establishing a service activity in a particular location within Australia, or establishing a segment headquarters in one State or Territory, an enormous array of complex State and Territory tax issues arise. Corporates and their advisers considering these types of transactions within the group must grapple with State stamp duty exposures in relation to any restructures and other State taxes payable in relation to transactions with customers.

The inefficiencies of such a system are self-evident and act as a strong deterrent to what should be everyday business transactions in Australia.

The Federal and State Governments must work together to eliminate the most economically inefficient taxes (such as stamp duties) from our tax system and address the unnecessary compliance costs associated with differing regimes across States by aligning or grouping regimes. Addressing vertical fiscal imbalance must be done as part of this process.

As acknowledged in the Discussion Paper, the Government's review of the roles and responsibilities across the Federation (which will culminate in a white paper on the Reform of the Federation) provides a unique and important opportunity to examine the system as a whole. An integral part of such a review must be to address this perennial issue, which has long been one of the most inefficient and costly areas of our tax system.

CHAPTER 10 – COMPLEXITY AND ADMINISTRATION

Like many tax systems, Australia's tax system has become increasingly complex over time. Some parts of the Income Tax Act have been recognised by the Australian Courts as virtually indecipherable.

Question 56 – The main causes of complexity

There are many contributing factors to the complexity of our current tax system, the most obvious being the following:

- Frequent changes to the tax system.
- Time lags in announcing changes to the tax system and implementing those changes.

- Treasury and law drafting resource constraints.
- A tendency to patch the law to provide for particular outcomes, rather than addressing the underlying problem.
- A lack of care and maintenance of the tax system, combined with limited Parliamentary airtime for related changes.
- Unclear or complex policy.
- The push from taxpayers for certainty versus the push for policy advisers to address every conceivable risk. This tension tends to favour black letter law, which is inherently complex and gives rise to uncertainty when new situations inevitably surface and are not covered.
- A general tendency towards over regulation in Australia.

The Cost of Complexity

We strongly support a reduction of complexity in our tax system to enhance efficiency. As noted in the Treasury Architecture Paper of August 2008”

“Every hour spent by households and business grappling with the myriad of tax rules and obligations... is an hour not used to produce goods and services ... that are of a higher value to Australians”.

Large business devotes an alarming amount of resources to complying with the complexities of the tax system, to the detriment of productive, income producing activity.

Although it is understood and accepted that large business will always be subject to more scrutiny than other taxpayer groups due to their size and contribution to tax revenues, the compliance costs associated with the fulfilment of tax obligations at the large end of the market often well outweigh the related revenue collected. And although there is also a growing acceptance of the need for corporates to be transparent in their dealings with the Australian Taxation Office (ATO), the enormous cost of complying with information requirements such as the International Dealings Schedule and transfer pricing documentation are rarely taken into account.

It is also worth noting that although large business is often presumed to be sufficiently resourced to deal with the complexities associated with the tax system; these resources are becoming increasingly limited as business looks to reduce operating costs across the board. It is also indisputable that these resources, insofar as they are dedicated to deciphering and complying with overly complex tax law or information requirements, would be better utilised in productive, income producing activities.

The CTA has identified three areas where compliance costs (which are largely due to complexities within those areas) are disproportionate to the benefit or revenue they produce:

- Compliance with the FBT
- Preparation and lodgment of the International Dealing Schedule

- Preparation of transfer pricing documentation

The CTA will be conducting member surveys across these areas over the next few months. The objective of these surveys will be to highlight the significant compliance costs associated with these three areas of the tax law with a view to determining whether there might be other, more effective ways to comply with the various requirements while reducing disproportionate compliance costs. We are happy to consider any specific questions Treasury would like us to include in these member surveys.

Question 58 – Reducing Complexity in our tax system

Much of the complexity in our tax system stems from taxpayer expectations of what the system will deliver in terms of certainty. As recognised in the Discussion Paper, the more taxpayers want certainty about particular provisions (and the more taxpayers seek to exploit weaknesses in the law to minimise tax) the more pressure there is for legislative change. Conversely, the more pressure there is on income taxes to support our economy, the higher the stakes for the policy advisers who feel compelled to address every perceived risk in the system.

A Principles Based Approach

The obvious answer to breaking out of this cycle is to move away from black letter law towards principles based design, which relies on clearly articulated policy outcomes. For such an approach to be successful the ATO needs to be willing and able to deliver certainty for taxpayers through the administration or interpretation of the law.

For taxpayers to support such a change in process there needs to be a level of trust in the ATO's capabilities and approach to the administration and interpretation of the law. If taxpayers do not trust the ATO to provide certainty in line with the operating principles of a particular law (rather than in terms of raising revenue), then such a change will not succeed.

The ATO's support of the recently announced statutory remedial power is a positive indication of its willingness to take on a more proactive role in administering our tax system to assist taxpayers in meeting their obligations. The Commissioner's use of that power, once introduced, will be a good test of the ATO's ability to deliver certainty for taxpayers through the administration of the law.

Care and Maintenance of the Tax System

The Government's attempt to address the backlog of announced but un-enacted measures in late 2013 highlighted one of the greatest deficiencies in our tax system – the lack of any process to care for and maintain the existing tax framework.

Extremely limited Treasury and drafting resources are stretched across all Government priorities, which tend to be based around changes which are either costing or raising

revenue. Long lead times between the announcement of changes and the introduction of legislation inevitably lead to uncertainty, which in turn gives rise to the need for further patching of the law. Meanwhile, the underlying systemic problem with the law remains, waiting for the next opportunity to raise its head and create more complexity and cost for taxpayers.

Room must be made within the current system for care and maintenance of our existing tax framework. Although there will always be a place for amendments to existing tax law, those amendments should first be looked at in the context of whether there are any underlying systemic problems with the relevant law. When it is found that there are such problems, adequate support should be provided (both in terms of resources and Parliamentary attention) to address those underlying issues. To continue on the path of patching the law to fix particular outcomes without any consideration of whether the system might need structural improvements will only result in further complexity and an ever growing list of announced but un-enacted tax measures.

Question 59 - The role of the ATO in reducing the impact of complexity

The ATO has an important role to play in reducing complexity in the tax system. There are challenges in making interactions between large corporates and the ATO as productive and effective as possible. These challenges are generally related to the complexity of the issues affecting large corporates and the revenue associated with those issues.

The ATO is committed to its Reinvention Program and has consulted extensively on how the ATO can make it easier for taxpayers to understand and comply with their obligations. For large corporates, certainty, timely advice and providing reasonable outcomes that are consistent with policy objectives are the key to having an effective relationship with the ATO. Such outcomes cannot be achieved without trust and an understanding of the tensions and sensitivities of both parties.

From the ATO's perspective, more focus needs to be given to providing practical certainty for large corporates, rather than 'stop sign' advice. This requires a change in culture from within the ATO, which has traditionally resisted providing administrative (or legislative, where the law permits) solutions that make it easier for taxpayers to fulfil their obligations. We note that the ATO recognises this need and through its Reinvention program has committed to making positive changes to the ways in which large corporates can gain practical certainty through its interactions with the ATO.

As is noted in the Discussion Paper, tax administration cannot eliminate the impact of complexity, but it can certainly reduce it. This observation certainly applies to the ongoing and regular interaction between large corporates and the ATO.

CHAPTER 11 – TAX SYSTEM GOVERNANCE

The governance of our tax system is an important issue for all taxpayers. Having a

transparent and accessible process for the development of tax policy results in increased certainty for all taxpayers and limits the chances of new or changed tax policy having unintended consequences.

Question 63 – Improving tax policy development in Australia

The CTA notes that consultation with affected taxpayer groups on the development of tax policy has improved in recent times, with Treasury and the ATO working together to seek input into tax policy announcements and where possible, on tax policy design (see further comments under ‘consultation prior to announcement’).

Despite these improvements, significant gaps in the process still exist around the areas of retrospective tax laws and announced but un-enacted legislation. Tax law is a dynamic area and requires a level of agility to ensure that necessary amendments are made in a timely manner. Significant lags between announced tax policy decisions and accompanying law have a direct impact on certainty and business sentiment. Although the Government has attempted to address this concern through its ‘Restoring integrity in the Australian Tax System’ initiative in 2013, limited resourcing and other Government priorities has seen the list of announced but un-enacted measures continue to grow.

Effective and timely consultation on tax policy cannot overcome the problems associated with a system which is perpetually stuck in ‘catch up’ cycle. What is needed is a dedicated and effective process which ensures that announced tax policy decisions are legislated within a reasonable time frame, along with a commitment to prospective legislation (with the limited exception of integrity measures) given the significant uncertainty that retrospective application creates.

Development of ‘Competitive’ Tax Policy

There appears to be a ‘governance gap’ in relation to competitive tax policy development in Australia as distinct from tax collection or integrity measures. Based on our understanding of tax policy development, there seems to be a lack of clear accountability for tax competitiveness policy within Treasury.

In our view, Australia needs stronger governance over tax policy development to ensure that our system remains competitive. We note that the recently revised role of the Board of Taxation could play a significant role in advising Treasury in relation to strategic issues around business tax competitiveness in Australia.

Consultation Prior to Announcement

The Discussion Paper notes that although Treasury does on occasion engage in confidential consultation prior to the formal announcement of tax policy, the vast bulk of consultation on policy development occurs on specific policies after announcement.

In our experience, the optimal consultation process follows a reasonably straightforward path:

- Identification of the issue(s).
- Consultation on those issues and how they might be addressed.
- Announcement of measures which effectively target the identified issues.

Consultation on a tax policy decision prior to a formal announcement provides Treasury with an in depth understanding of the commercial impacts of the tax policy decision and enables both Treasury and the ATO to implement and administer laws that align with the underlying policy. Consultation at this stage of tax policy development also limits the chances of a new tax policy having unintended impacts on the tax system.

In following this process, we recognise and understand that there can be disagreement over the best way to address an issue or concern, or indeed whether the identified issue or concern in fact warrants any policy change. We also recognise that it is open to Government to change its position on policy, for a range of valid reasons. What is assured, however, in following this process, is that all parties - the ATO, Treasury and taxpayers - have a shared understanding of the issues or concerns and each party has had an opportunity to raise their concerns and hear the views of the other parties.
