Re:think tax discussion paper: EY Submission

1 June 2015

Building a better working world

Tax White Paper Task Force
The Treasury
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Dear Manager

Re:think tax discussion paper: EY Submission

EY welcomes the opportunity to make a submission on the 'Re:think' tax discussion paper (RDP) released on 30 March 2015 as a first step in the Tax Reform White Paper process (we refer to this as the TRWP process).

EY has been an active participant in Australia's tax reform processes and reviews including:

- the Australia's Future Tax System review commenced in 2009 under the leadership of Dr Ken Henry (Henry Tax Review), to which EY and the Corporate Tax Association (CTA) made joint submissions[1]
- the Ralph Tax Review of Business Taxation in 1999 (Ralph Review) and subsequent reviews by the Board of Taxation of aspects flowing from that review, include the 2003 Review of International Tax Arrangements (RITA)

EY also regularly contributes to Treasury, ATO and Board of Taxation reviews and/or consultation processes, as well as other tax review initiatives for example submissions to:

- the State Tax Review in South Australia on 24 April 2015
- the Senate Inquiry into Corporate Tax Avoidance on 2 February 2015
- the Business Tax Working Group 2011-12

Our submission, in the Appendix, makes preliminary comments on the tax reform process before addressing the specific issues raised in the RDP. This summary identifies selected important issues.

The tax reform process

Australian governments have initiated many reviews of Australia's tax system, including those mentioned above.

This TRWP process occurs concurrently with two other major reform initiatives that will also affect Australia's tax system:

- the Federation White Paper process which seeks, amongst other things, to address the services and expenditure responsibilities of State governments and the adequacy of their revenue streams to finance those spending responsibilities (to be completed in 2015) and
- the global initiative by the G20, the Organisation for Economic Co-operation and Development (OECD) and less developed countries in developing an Action Plan focused on adjusting international tax policies and laws to combat base erosion and profit shifting (BEPS) (global BEPS initiative), with recommendations by 2015 for implementation over time.

The recommendations arising from those processes will need to be considered alongside any input developed in the TRWP process in order to be workable. That will involve further policy decisions to be made by Federal and State governments, relating to state taxes and the goods and services tax (GST).

[1] http://taxreview.treasury.gov.au/content/submissions/post_14_november_2008/CTA_and_Ernst_and_Young_Joint.pdf

Priorities for tax reform – improving tax reform governance

Tax reform is an ongoing, time-consuming and complex process involving various sections of the community, at State, Federal and global levels. This has historically given rise to political, economic and social challenges to implementing optimal tax reform. And it is giving rise to the same problems in the current political environment.

We therefore submit that **improving tax system governance** relating to tax reform should be a priority for the Government in this TRWP process (referred to in Chapter 11 of the RDP).

In the EY 2014 paper 'Tax reform - A better way – The Case for an Australian Tax Reform Commission'[2] we listed the ongoing reform tasks which we consider should be managed under the remit of an independent commission:

- Regular whole of system tax reviews – which might be an outcome of the TRWP but is not clear
- Consultation on specific tax policy proposals
- Ongoing tax law and reform maintenance and consultation
- Post-implementation reviews of laws and tax rules

But the challenges for this and previous governments include competing calls for parliamentary and government attention and political challenges which affect efficient management of all the priorities.

There is a problematical tax reform environment in Australia. A loss of public confidence in the reform process arises in part from the "implementation" of the Henry Tax Review. The intensely politicised tax reform environment, including the current environment before and after the release of the RDP, means that the public does not see a fully presented package of reform, which involves all sectors giving and taking to achieve a better tax system. Instead, the environment sees significant special interest groups from all sides of the political divide, as well as tax reform agencies, seeking media and public attention. The resulting clamour of debate makes it very difficult to discern and set the direction for reform which will benefit Australia's overall interests.

EY believes there needs to be a better way to manage the necessary and valuable tax reform process.

EY has proposed the establishment of an Australian Tax Reform Commission, reporting to Government as do the Productivity Commission and Law Reform Commission, to manage the development and assist in implementation of tax reform, providing public recommendations to Governments.

In the current tax reform environment a Tax Reform Commission will help Australia by:

- Operating independently of political concerns (in the same way as the Productivity Commission, Law Reform Commission or Reserve Bank), overcoming perceptions that many current stakeholders or think tanks of whatever political persuasion are not independent
- Giving independent advice to governments and the public, leaving the decisions to governments, like the Productivity Commission or Law Reform Commission
- Bringing an enduring focus on tax reform unlike stop-start reform approaches subject to political timelines
- Addressing challenging issues, recognising that some of the most successful tax reforms did not start out being popular
- Engaging with the public and 'socialising' strategic and tax system repair issues, including identifying selected experts to assist in this process

We discuss our proposal in the Appendix, ahead of further input we will provide later in 2015,

We now respond to selected other questions in the RDP.

[2] http://www.ey.com/AU/en/Services/Tax/EY-tax-reform---a-better-way---overview

The tax landscape

Globalisation

We agree with comments in Chapter 1 that Australia's tax system faces challenges as a result of the rapidly changing economy and demographic shift.

Globalisation and an increasingly digital economy mean that:
- Australian businesses and Australian workers operate globally
- Australian businesses and Australian workers are mobile. Individuals and businesses can relocate overseas and carry on many business activities easily, including serving the Australian market
- Foreign businesses and foreign workers can come to Australia if attracted by our business and possibly tax conditions

Australian tax laws need adjustment to deal with the changed business and indeed personal tax environment. This is not just about the measures to deal with global BEPS initiatives, nor is it just about digital-services and digital-goods companies. We note in passing that the digital economy also presents opportunities for tax authority information collection processes which can assist with information gathering, compliance and future proofing Australian tax administration.

Globalisation also means that Australia's tax system must be competitive, and should not be considered in isolation. Australia is a small open economy relying to a significant extent on foreign direct investment. Australia has no global monopoly on talented people or sophisticated financial markets or manufacturing skills or mineral resources or IT creative skills – there are countries competing strongly in every investment and export sector. Australia should have a tax system that:
- attracts appropriate foreign investment and does not discourage it
- positions Australia as an attractive location for mobile Australian people and business rather than pushing them to move overseas to find their potential and growth.

Australia's taxation of international business must therefore, from a strategic viewpoint, align to international practice, including in relation to measures arising from the global BEPS initiatives. Australia should continue to participate in global BEPS initiatives and seek to align domestic reforms with international efforts for efficiency and competitiveness reasons.

Australia's tax system is in many respects world leading and continues to be the subject of ongoing policy activity and reviews which we support (subject to our comments regarding improvement of process). Any proposed reforms of Australia's tax system should continue to be a consultative and sophisticated fine-tuning of our already robust system.

Australia's tax burden and tax mix create strategic risks

We see comments in the RDP that Australia has a comparatively low tax burden as a percentage of GDP. In our view, Australia is not a low-tax country. We question the presentation of this issue.

We do, however, agree that Australia's tax mix relies too heavily on corporate and personal taxes.

Australia taxes employment and business income – the outcomes of growth-producing activities - more heavily than do comparable countries. This is a great concern if we want to enhance productivity and participation, to grow the economy rather than merely redistribute income. Also, Australia taxes those who consume, and spend, less than other comparable countries.

The tax mix needs to be revised to appropriately balance the tax burden between different taxpayer groups. It is also important to preserve the international competitiveness of Australia's corporate and individual tax system to ensure revenue can continue to be raised in a changing world economy.

Australia's personal tax rates for middle to higher income taxpayers are too high. Table 3.2 in the RDP presents the highly progressive nature of the personal taxes.

The high personal tax rates for Australia's higher income workers constitute potential impediments to greater workforce participation, and encourage mobile workers with valuable skills to work overseas rather than in Australia.

Australia's tax system should encourage the development of successful businesses which employ people and contribute to economic welfare.

Attracting foreign investment and investment into specified sectors

The RDP identifies the barriers which Australia has to achieving a low corporate tax rate for all companies. The RDP asks whether low corporate tax rates are the main attractors of foreign direct investment into Australia and at questions 30-31, whether and how tax can be designed to attract investment into particular targeted sectors of the economy.

Australia's overall level of taxation is a relevant factor when foreign investors look to Australian investment. Foreign direct investors look not just to the 'sticker' or nominal tax rates in Australia but to the overall impost of tax on their investments. It is important not to have an uncompetitive tax rate given Australia's 2% share of global economic activity.

Australia could consider, as a means of attracting foreign direct investment, reintroducing targeted tax concessions designed to stimulate investment in particular industries or sectors. The precedents are many, from Governments of all political persuasions, and include:

- investment allowances (bonus tax deductions targeting typically investment in new equipment)
- development allowances (bonus tax deductions providing tax concessions for specified new investments including expenditures other than on equipment-type physical assets)
- accelerated depreciation (including depreciation loadings, and outright deductions such as the new small business depreciation incentive in relation to certain small business assets)
- Incentives for intellectual property not principally physical equipment, such as development of brands, trademarks, processes, software (eg. R&D incentives targeting designated expenditure).

Targeted incentives provide an efficient means of targeting desirable investment and stimulating the economy, addressing productivity, participation and growth issues in a carefully targeted manner.

We highlight that these concessions need not be targeted only to investment in tangible fixed assets 'bricks, mortar and machinery' but also to the development of intangible assets such as copyrights, patents, trademarks, know-how and new Australian expertise.

The global BEPS initiative does not prevent Australia from providing tax concessions which involve substantial business activity. This practice is undertaken by all developed and developing countries. As an example, various European countries have recently introduced "Patent Box" style incentives based on substance criteria and with within the BEPS framework.

Employment taxes

We comment on Australia's fringe benefits tax and other issues relating to the taxation of employees. We place the comments into our analysis of business tax issues as they affect employment. In particular we identify the need for:

- Directions for reform of the fringe benefits tax, which do not involve a simplistic transfer of the current obligations to employees but instead the need for further study
- Changing the Australian living away from home allowance (LAFHA) changes introduced in 2012. Like the 2012 employee share scheme (ESS) rules which were excessive and which have required change supported on a bi-partisan basis, there is an urgent need to review the 2012 LAFHA changes. These rules are adversely impacting Australian labour competitiveness, both from an inbound and outbound perspective
- Abolition of the employment cessation taxing point under ESS rules.

Dividend imputation system

The imputation system provides a mechanism to properly avoid double taxation of company income distributed to investors. The RDP outlines that many countries without imputation have engineered or replaced it with other mechanisms to avoid double taxation.

In our view the imputation system should be retained. It can however be improved to prevent foreign income distorting Australian companies' attractiveness to investors, and to encourage appropriate outbound investment. Further we support the mutual recognition of Trans-Tasman imputation credits.

Savings tax matters

We highlight that the capital gains tax (CGT) discount was introduced to replace the CGT inflation-indexation adjustment and for other reasons. Calls for abolition of the CGT discount do not properly analyse the factors in play here. We recommend that the TRWP process should see more comprehensive analysis of this issue, as the public will not be aware of the issues at hand.

In relation to the design of Australia's superannuation system, we are concerned about the simplistic nature of the debate about superannuation concessions. This is an area where further transparent study is in our view desirable. That study should include coverage of:

- Tax superannuation concessions reduce the obligations of Governments to fund retirement income streams to older Australians, when tied into age pension asset and eligibility requirements. Tax concessions play an important role in reducing future pension expenditures.
- A large part of the claimed superannuation "expenditures" represent no more than tax benefits provided to employers in meeting their superannuation guarantee obligations which have been mandated by Governments, and indeed are to further increase. Those claimed tax expenditures are no different to tax deductions for wages, salaries and compensation.
- The appropriate tax design of superannuation funds' assets supporting age pension streams, including the tax rationale for that setting which has been in place for many years
- As well as the interaction of these settings with equity issues.

We accept that fine tuning of the superannuation laws is required, but we are concerned that the current heated debate creates a risk of excessive and inappropriate changes which will damage the savings environment in Australia.

Reducing tax uncertainty

We support **reducing complexity and uncertainty** in the tax system (Chapter 10 of the RDP) to increase business confidence and investment in Australia. This includes:

- This Government's focus, in announcements on 6 November and 14 December 2013 to reduce the backlog of announced but unlegislated measures to provide certainty.
- With new measures, giving taxpayers enough time to implement them. With tax laws becoming increasingly complex and often involving significant investment in systems, taxpayers should be provided with greater lead times to understand and implement changes.
- Providing regulatory bodies such as the ATO with more discretionary powers to resolve matters efficiently as recently announced by the Government. Appropriately, these powers should be exercisable only in favour of taxpayers - given the lack of trust in the neutral administration of the tax law by the ATO - and given that it is the role of parliament to impose new forms or heads of taxation.

This submission is intended to provide high level directional comments to help Treasury and Government shape the next step in the TRWP process, which we understand might be an Options (Green) paper. As noted above, EY has actively participated in tax reform consultation over the years and has previously responded on many of the issues being addressed in this paper.

We plan to provide more detailed comments on the design and implementation of tax rules when the Options paper is released.

To discuss this submission further please contact, in the first instance, Craig Robson, Oceania Tax Leader on (08) 9429 2271 or Alf Capito, Tax Policy Leader Asia Pacific on (02) 8295 6473.

Yours sincerely

Alf Capito
Partner, Tax Policy Leader Asia Pacific
Attachment: Appendix

Re:think tax discussion paper: EY Submission

Priority for attention – Tax Reform: A better way

While this issue is encompassed in the RDP's discussion of Tax System Governance' (Chapter 11), we think it is a key priority in this TRWP process. We discuss it before turning to points of detail.

Tax reform is an ongoing, time-consuming and complex process involving various sections of the community, at State, Federal and global levels. This has historically given rise to political, economic and social challenges to implementing optimal tax reform.

In the EY 2014 paper 'Tax reform - A better way – The Case for an Australian Tax Reform Commission'[3] we listed the ongoing reform tasks which we consider should be managed under the remit of an independent commission:

- Regular whole of system tax reviews – which might be an outcome of the TRWP but is not yet clear
- Consultation on specific tax policy proposals
- Ongoing tax law and reform maintenance and consultation
- Post-implementation reviews of laws and tax rules

We recognise the need for a truly independent institution, as many will be concerned about the risk of an institution that might be perceived as captured by politically-leaning members of one side or another. But we see that the Productivity Commission and Law Reform Commission are seen as accepted, respected, institutions shaping public awareness of issues. And we note that governments remain free to accept or reject their advice.

[3] http://www.ey.com/AU/en/Services/Tax/EY-tax-reform---a-better-way---overview

The challenges for this and previous governments include competing calls for parliamentary and government attention and political challenges which affect efficient management of all the priorities.

The highly complex tax reform environment in Australia, caused in part by a loss of confidence in the reform process arising from the "implementation" of the Henry Tax Review, shows that Australia needs an environment of greater public confidence in the tax reform process. In our view, the shortage of public trust in the tax reform process has grown more acute over the last five years.

The intensely politicised tax reform environment means that the public does not see a fully presented package of reform, which involves all sectors giving and taking to achieve a better tax system. Instead, we see pressure groups from all sides of business and the community pushing their sectional interests, seeking new concessions in income tax and indirect taxes, seeking media attention and distracting from the overall objective of a better overall tax system. Unless governments have strong political capital and strength in their respective parliaments, they are exposed to pressure to rule out or include various measures and are pushed in response to media and public political pressure, often with little truly independent analysis.

As we outlined in 2014,

> *'with so many bodies wanting their say, challenges arise when trying to manage meaningful and well informed communication. Challenges also exist in simply coordinating the process of reform. These challenges can often prevent sizeable coalitions forming that could agree on a grand bargain to support reform.'*

EY believes that there needs to be a better way to manage the necessary and valuable tax reform process.

EY has proposed the establishment of an independent Australian Tax Reform Commission to manage the implement tax reform, providing public recommendations to Government:

> *"Australia's tax system is a key factor in shaping our success as a nation. The world in which we live is constantly changing. To keep pace with this change, our tax system must also constantly evolve.*
>
> *Australia's tax system is unresponsive and has failed to react sufficiently quickly to recent developments in the domestic and international context. EY believes Australia should implement as a matter of urgency, processes and responsibilities that can improve the chances of successful and sustainable tax reform.*
>
> *Forecasts of ongoing budget deficits and the need for a globally competitive tax system mean pressure for further tax reform is building. In a changing world, no tax system can remain optimal for long. Policies that underpin the tax system must therefore constantly evolve to best suit the changing conditions.*
>
> *… EY recommends the establishment of a new body to take responsibility for tax reform. Being wary of the accusation of creating "yet more bureaucracy," the recommendation was reached only after carefully weighing the institutional advantages of linking the necessary processes to an independent statutory body.*
>
> *EY recommends that the Australian Tax Reform Commission be responsible and accountable for four separate but complementary outcomes including:*
>
> - *regular scheduled whole of tax system strategic reviews*
> - *consultation on specific tax reform packages and advice to government*
> - *yearly tax reform maintenance reviews*
> - *post implementation reviews of legislation and regulations*
>
> *EY recommends that the Federal Government encourages the States to support and participate in the establishment and activities of the Commission."*

Turning to the task of long term strategic reviews, which may be the final outcome of the TRWP, we said:

"Tax reform outcomes could be further improved if a more powerful mechanism was found to elicit from interest groups and government entities their views as early and as often as possible. This is one key reason why we have recommended the establishment of the Australian Tax Reform Commission.

The Commission should use consultation to identify opportunities and risks to tax reform. Consultation should be varied in format, including:

- *Requesting public submissions from stakeholders*
- *Interacting with stakeholders at public forums*
- *Perhaps accepting secondments from stakeholder institutions to the Commission*

Where interest groups are found to be at odds the Commission may choose to host public debates, conferences, summits, tax design competitions or other innovative approaches that could isolate and diminish sources of disagreement.

Where government entities are found to be at odds, the Commission may constitute committees imbued with the delegated power to resolve the issues."

The Tax Reform Commission could help resolve one area where Australia's current tax reform is certainly broken – the task of building effective packages of measures, with appropriate compensation arrangements, without political acrimony making it impossible to implement the reforms:

"Tax reform inevitably creates winners and losers. Successful tax reform often requires the bundling of tax reforms into packages that include trade-offs and compensation or that "share the pain" equitably.

While compensation is often key to making tax reform stick, making sure there are no losers can negate the benefits of the reform. Compensation in Australia has often been delivered by way of personal income tax cuts. That has a big advantage - governments are able to recoup lost revenue over time via "bracket creep" - the falling real thresholds of unindexed personal income tax. Of course the ability to "afford" full compensation is not always present. Sometimes it is necessary to ensure that the "pain" of tax reform is seen to be shared equitably.

Framing tax reform in a package that includes both winners and losers has proved successful in the past. But it is the credibility of the identification of the winners and losers from the package that is a key determinant of success.

Application - Piecemeal tax reform should be limited and compensation should be carefully designed.

Identifying the winners and losers and quantifying the relevant amounts both in the short and long term can be critical to the success of proposed tax reform proposals. The credibility of these assessments can play an important part. This suggests the need for a body independent to the operational arm of government to help give credibility to this process without removing the Government's ultimate decision making authority."

We support the need for tax reform in Australia.

We support Treasury and the existing institutions driving tax reform in Australia.

However, we reiterate that a new Tax Reform Commission could add significant value to the tax reform environment in Australia, as a better way to augment the institutional framework for tax reform. Otherwise, we, like many other participants, are concerned that the TRWP process will not achieve broader reform objectives.

The tax landscape

We agree with comments in the RDP that Australia's tax system faces two key challenges: the rapidly changing economy and demographic shift.

Does Australia really have a low tax burden?

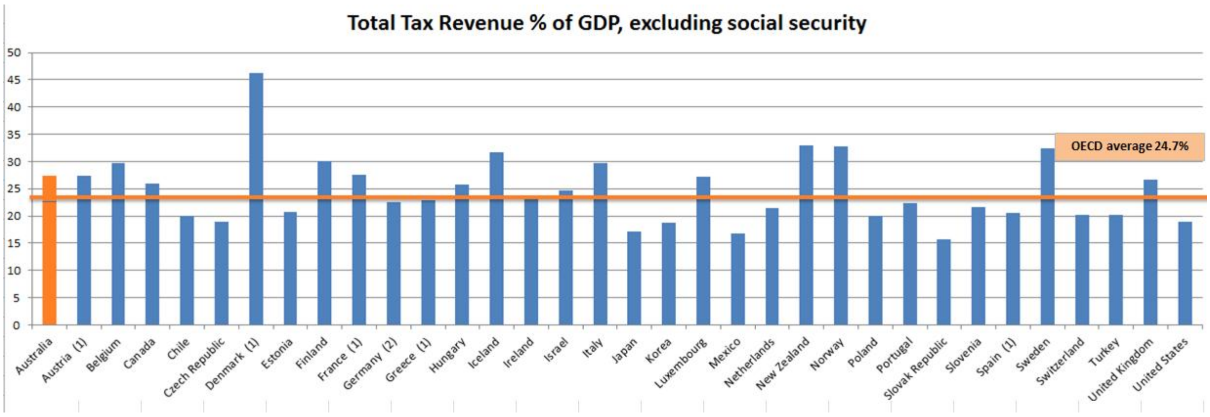
We see comments in the media, and in the RDP, that Australia has a comparatively low tax burden as a percentage of GDP. In our view, Australia is not a low-tax country. We question the presentation of this issue in Chart 2.2 and the comment made in relation to it that

> *"Australia's aggregate tax burden is relatively low compared with other developed countries, but higher than some of our major regional trading partners …Australia's compulsory superannuation system — the superannuation guarantee — is sometimes equated to a social security tax. However, as it is paid directly into private superannuation accounts (currently set at 9.5 per cent of an employee's ordinary time earnings) rather than to the government, it does not meet the definition of a tax."*

First, we note that the OECD average used is an unweighted average, not reflective of economic size or growth. Second, the chart shows that the countries competing with Australia for investment tend to have lower tax to GDP ratios.

But even more importantly, the discussion does not comment that there are different views on whether to allow for social security taxes. In other words, the chart excludes Australia's superannuation guarantee charges, but includes the social security taxes of other countries that include elements similar to our superannuation guarantee but classed as social security taxes.

Reflecting the need for clearer analysis of tax systems, the OECD prepares analyses both including and excluding social security taxes. The OECD Revenue Statistics 2014[4] contain a table of total tax revenue as a percentage of gross domestic product at market prices, 2012, including social security and also excluding social security. This shows:



If social security taxes are completely excluded from the analysis, Australia's tax to GDP ratio excluding social security taxes of 27.3% places it into the high tax group, with countries including Denmark, France, Norway, Sweden and the UK with similar ratios. The ratio is significantly higher as a tax to GDP ratio than OECD countries.

Dr John Hewson, in a 2014 paper for the ANU Tax and Transfer Policy Institute[5] observed:

[4] Revenue Statistics 2014, OECD 2014, Part II Table 1. Total tax revenue as % of gross domestic product at market prices, 2012, Version 1 - Last updated: 15-Oct-2014 http://www.oecd.org/tax/revenue-statistics-19963726.htm

[5] The politics of tax reform 11 March 2014, by Dr John Hewson, to the Tax and Transfer Policy Institute

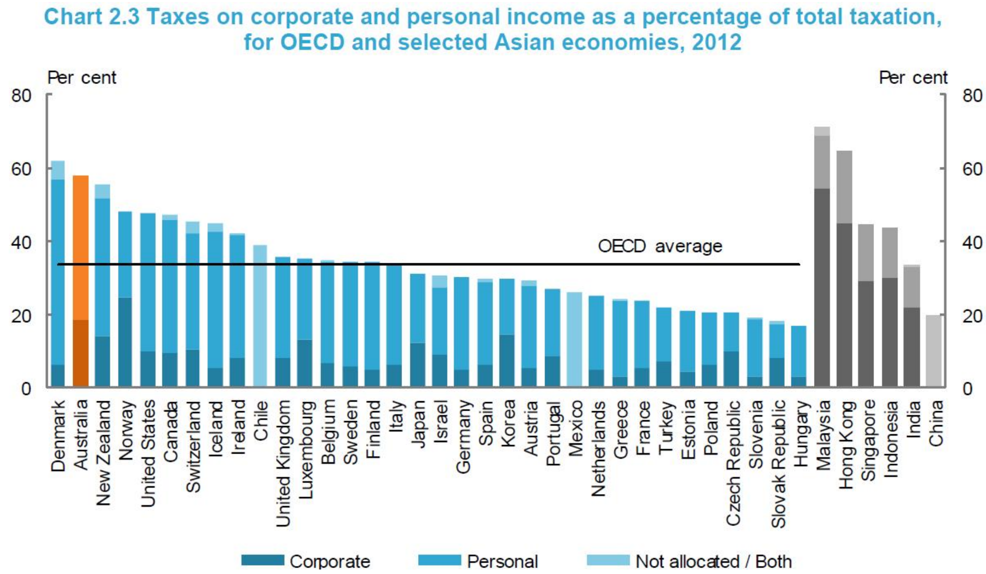
"our overall tax burden is low by OECD standards, although if we add employer superannuation contributions and private health insurance premiums (which are paid through taxes in many OECD countries), we about match the OECD average. Yet, we face billions of dollars of expenditure commitments in the Budget out years, especially Gonski, National Disability, infrastructure, NBN, ageing population, etc. in the context of limited capacity to cut expenditures short of a large-scale restructuring of Commonwealth/State responsibilities to eliminate duplication."

As well, if social security taxes are in the analysis, this has implications for setting tax policy on superannuation and savings policies.

We submit that this issue requires further public analysis. This is a critical issue which colours the public debate on taxation, superannuation, savings and tax levels. The brief current presentation in the RDP does little to dispel distortions in the debate.

Australia relies too heavily on income taxes

We agree with comments in Chapter 2 that Australia's tax mix relies heavily on corporate and personal taxes. This is compellingly outlined in Chart 2.3:

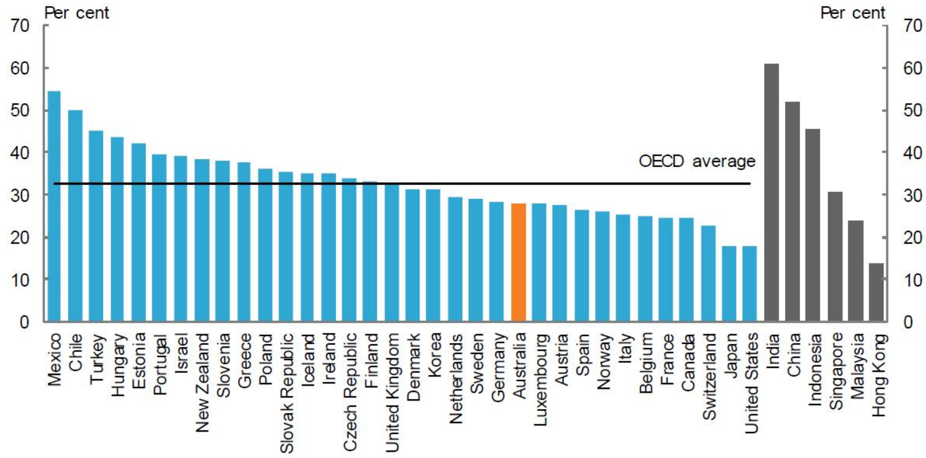


This chart shows that Australia taxes employment, and business income, and growth-producing activities more heavily than do most other countries.

This is a great concern if we want to enhance productivity and participation, to grow the economy rather than merely redistribute income without any concern for growth and the future. Australia also taxes those who consume, and spend, less than other comparable countries.

Source - https://taxpolicy.crawford.anu.edu.au/files/uploads/taxstudies_crawford_anu_edu_au/2014-09/the_politics_of_tax_reform_jh.pdf

Chart 2.5 Consumption taxes as a percentage of total taxation, for OECD and selected Asian economies, 2012



The tax mix needs to be revised to appropriately balance the tax burden between different taxpayer groups. Looking to the appropriate tax mix, it is also important to preserve the international competitiveness of Australia's corporate and individual tax system to ensure revenue can continue to be raised in a changing world economy.

Australia's personal tax rates for middle to higher income taxpayers are too high. Table 3.2 in the RDP presents the highly progressive nature of the personal tax mix numerically. Our analysis is below.

In our view, the high personal tax rates for Australia's higher income workers constitute impediments to greater workforce participation, and incentives for mobile workers with valuable skills to work overseas rather than in Australia.

Individuals' Taxes

The 2015 Intergenerational Report highlighted that longer lives and demographic shifts mean there will be fewer people of traditional working age as a proportion of the population. This has important implications for the tax base and how future governments will fund the services the community needs and expects.

Australia's personal tax system is highly progressive, which presents a barrier to participation by individuals and indeed might be a driver for Australians wanting to go overseas. Table 3.2 of the RDP shows that Australia's lowest income taxpayers do not in fact pay significant tax and the individual income tax is overwhelmingly paid by the middle to high income taxpayers.

Australia's tax rates are highly progressive. That table shows that, in the latest year for which comprehensive statistics are available:

- 18.3% of individual taxpayers have incomes $16,000 or less and pay no personal income tax
- Taxpayers with $16.001-37,000 of income are 27.3% of taxpayers but pay only 3.7% of individual income tax
- Individuals earning $80,001-$180,000 are 14.5% of personal taxpayers but pay 26.1% of personal tax
- Taxpayers earning over $180,000 of income are only 2.3% of the taxpayer population but pay 26.1% of personal tax collections.

We present these numbers as follows

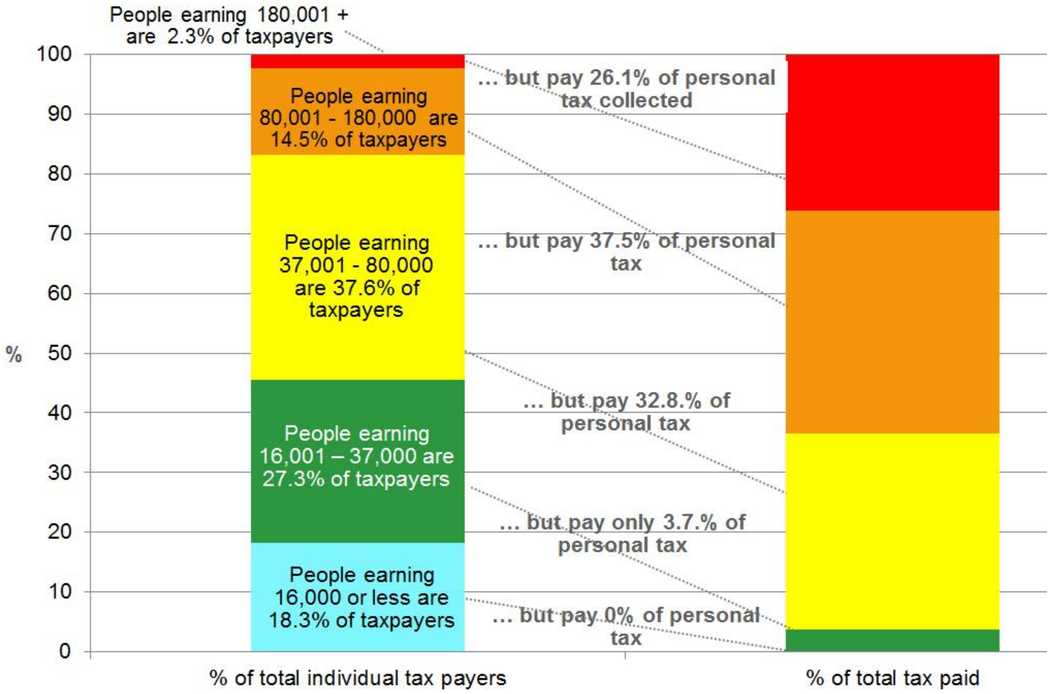
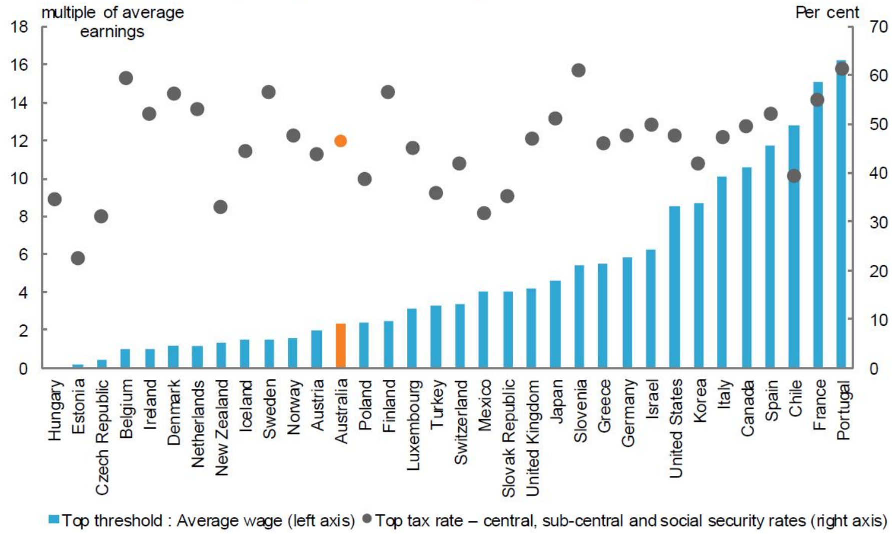


Chart 3.4 in the RDP is also of concern, showing the top tax rate in OECD economies (the bulleted marks) and the multiple of average earnings at which the top tax rates starts (the bars).

Chart 3.4 Top marginal tax rates comparison, OECD countries, 2013



This chart shows that, broadly:

- Australia's top personal tax rate cuts in at only twice average weekly earnings
- The countries to the left of Australia in the chart (top tax rate at twice AWE or less) are not growth economies and most of them have lower top tax rates than Australia
- The growth economies in the chart, like US, Canada, Israel, UK, etc. have the top personal tax rate commencing at multiples of 6 or 8 or 10 times AWE
- The chart does not include non-OECD competitor countries to Australia, which are attractive to Australians, such as Singapore, Hong Kong, Malaysia.

The chart shows clearly that Australia is in fact a high taxing country for personal taxpayers. These tax features are concerning when thinking about productivity and participation. It suggests that there is little tax incentive for Australians to work harder and smarter or more valuably in Australia's economy. This is a challenge for enhancing productivity, participation and retaining talented Australian individuals to work in Australia.

Savings

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

We see public discussion of the CGT discount, including calls by some advocacy groups for it to be abolished, to increase personal taxes to fund their preferred welfare expenditures. Much of this public writing is incomplete and misleading.

It is important in the TRWP process to outline the history and purpose of the CGT discount, to enable more considered policy discussion of this issue. As well, most countries offer lower tax rates on capital gains, for sound tax policy reasons and the Henry Review recommended retention of the CGT discount, with modifications.

We say that the TRWP process should commission some public, transparent analysis of CGT treatment in other countries, otherwise this entire segment of the tax debate will be distorted and lead to poor policy.

CGT indexation, which applied before the CGT discount, and its problems

The capital gains tax (CGT) discount of 50% was introduced (following the 1999 Ralph Review) as a replacement of the previous system of indexation of the cost base of assets included when the CGT measures were introduced in 1985. The CGT discount is no longer available for non-residents, nor is it available for companies.

Australia's CGT was introduced by the Hawke-Keating government providing asset owners with an annual inflation adjustment by way of indexation at the consumer price index (CPI) rate ('indexation').

That previously used indexation methodology, which is still available for assets purchased between 1985 and 1999, involved calculating for each asset its indexed cost price by reference to historical CPI tables, and the indexation adjustment might be more or less than 50% depending on the duration and dates of holding the asset. This gave rise to complicated rules with many calculations. In the common situation where a taxpayer might buy a capital asset in year 1 and might spend money every year on improving it, adding to the CGT cost base, then every year's additional expenditure would have different indexation adjustments applied to it. For example, when a taxpayer had say 3 capital assets with say 10 years' additional expenditures enhancing the asset value (not otherwise deductible), they would be required to track 33 CGT elements of indexed cost base (11 for each of the 3 assets). The compliance costs were high and complex, especially for ordinary Australian individuals, and added to compliance costs.

The previous methodology also contributed to a reluctance of investors to sell CGT assets. This meant that Australia in the 1990s saw private owners of businesses and assets being unwilling to sell their assets to new owners to make more productive use of the assets, resulting in a low velocity of transactions.

Why the CGT discount replaced indexation

The rationale for the introduction of the CGT discount in 1999 is still valid today and derives from Ralph Review recommendations 18.2 and 18.3. These recommendations were:

> *"designed to enliven and invigorate the Australian equities markets, to stimulate greater participation by individuals, and to achieve a better allocation of the nation's capital resources."*

So a significant policy intention was to reduce the CGT 'blocker' which was leading to the lock-in of assets, to slow-moving assets not being utilised efficiently. The CGT discount rules were also intended to simplify aspects of the CGT law and reduce compliance costs for eligible individuals, trust and complying superannuation entities or trusts. The aim of the reforms was to make the provisions more accessible and flexible, thereby encouraging capital investment and turnover in Australia.

We note also that the CGT discount was recommended by the Ralph Review after a time of high inflation. If Australia had a sustained period of higher inflation, then a return to an indexation methodology would reduce government revenue.

More recent analysis

In 2008, the Architecture of Australia's Tax and Transfer System" paper, issued by Treasury in August 2008 as a precursor to the Henry Review, concluded that "Among the OECD-10 countries, Australia has one of the higher top personal tax rates on capital gains, notwithstanding the 50 per cent discount available for gains on assets held for at least 12 months".

An OECD 2013 working paper[6] reviewed countries' treatment of capital gains, principally for shares but also looking to capital gains on other assets, focused on individual investors. Its analysis included:

> *"With five exceptions, OECD countries tax the nominal amount of the capital gain"*
>
> *"Several OECD countries apply a holding period test which reduces or eliminates taxation of capital gains on an asset that has been held for longer than a certain period.…The most common impact of a holding period test is that capital gains on assets held for longer than the fixed period are exempt from taxation. Other OECD countries apply a more favourable tax treatment on gains on assets that are realised after the expiry of the applicable holding period …In other countries, the type of tax treatment will change to a more favourable form after the prescribed holding period …*

Table 12: Summary of nature and impact of holding period tests

	Change in tax treatment after longest holding period		
	Reduced rate	**Exempt**	**Change in system**
Type of holding period test - **Single-point test**	Finland Japan (property) Luxembourg (property)	Belgium (property) Chile Czech Republic Italy (property) Luxembourg (shares) Poland (property) Slovak Republic (shares) Turkey	Australia Austria (property) Portugal (property) United States
- **Progressive change**	Korea (property)	France (property) Hungary Slovenia	

> *… a range of approaches to taxation at the personal level are applied to interest income and capital gains on shares across the OECD."*

For example, in the UK:

- Until April 2008, the UK taper relief applied, which proportionately reduced the net capital gain the longer the asset was held by individuals, trusts and personal representatives. Similar to Australia's CGT discount rules, the UK taper relief did not apply to companies
- The UK taper relief was replaced with Entrepreneurs' Relief.
- UK capital gains tax for individuals involves an annual exemption, and then any capital gain in excess of the exemption is taxed at discounted rates, see website of UK government[7]:

> - If you pay higher rate Income Tax
>   You'll pay 28% tax on your gains if you're a higher or additional rate taxpayer.
> - If you pay basic rate Income Tax

[6] Harding, M. (2013), "Taxation of Dividend, Interest, and Capital Gain Income", OECD Taxation Working Papers, No. 19, OECD Publishing. http://dx.doi.org/10.1787/5k3wh96w246k-en

[7] https://www.gov.uk/capital-gains-tax/work-out-your-capital-gains-tax-rate

You'll either pay 18% or 28% tax on your gains if you're a basic rate taxpayer. ….

The Henry Review (Australia's Future Tax System – Report to the Treasurer) considered the potential reform of CGT. Its recommendations in relation to the CGT discount, which we do not necessarily agree with but present to show the intricate nature of the various policies, included:

> *"Recommendation 14*
>
> *Provide a 40 per cent savings income discount to individuals for non-business related net interest income, net residential rental income (including related interest expenses), capital gains (and losses); and interest expenses related to listed shares held by individuals as non-business investments.*
>
> *... further consideration should be given to how the boundaries between discounted and non-discounted amounts are best drawn to achieve certainty, reduce compliance costs, and prevent labour and other income being converted into discounted income….*
>
> *Recommendation 15*
> *… a smooth transition should be provided to minimise any disruption that may arise … to the supply of housing … and reforms to housing assistance …"*

TRWP process should explain the full facts to the Australian community

The TRWP process should involve transparent and truly independent research into the rationale for lower capital gains tax rates, to ensure that capital assets turn over and the proceeds are reinvested for the health of the economy, to avoid capital being 'blocked' or being exported from a country.

If this action is not taken, the public debate will continue to be misled by groups simply seeking greater tax revenues, without thought to Australia's broader long term economic interests.

We say this illustrates why a permanent Tax Reform Commission is a critical institution for Australia, to present the full facts to a public not expert in tax law, policy or history.

Question 22 – Superannuation

In relation to the design of Australia's superannuation system, we are concerned about the simplistic nature of the debate about superannuation concessions.

This is an area where further transparent study is in our view clearly needed. The study should include coverage of:

- The changed circumstances arising from the changing demographics of the Australian population
- Much of the claimed expenditure on superannuation concessions reduces, because of its linkage with age pension asset and eligibility requirements, the obligations of Governments to fund retirement income streams to older Australians. In other words tax concessions play an important role in reducing Government welfare outflows. As noted in the Henry Review Retirement Income Consultation Paper[8]

  > *"The tax concessions for compulsory savings do not encourage savings but may be seen to compensate individuals for the inability to use these savings for other purposes, which they may value more highly than retirement savings. Providing concessions to compulsory saving may also reduce the need for individuals to make additional voluntary saving."*

[8] Henry Review Retirement Income Consultation Paper, 2008, chapter 3 http://taxreview.treasury.gov.au/content/ConsultationPaper.aspx?doc=html/publications/Papers/Retirement_Income_Consultation_Paper/Chapter_3.htm

- A large part of the claimed superannuation expenditures represent no more than tax benefits provided to employers in meeting their superannuation guarantee obligations which have been mandated by Governments, and indeed are to increase further. Those claimed tax expenditures are no different to tax deductions for wages, salaries and compensation.

- The appropriate tax design of superannuation funds' assets supporting age pension streams. This needs to explain the tax rationale for that setting which has been in place for many years

- And the interaction of these settings with statistics of a small number of people who benefit to a perceived inappropriate level. That analysis needs to factor in the full range of government incentives for superannuation including government co-contributions for low to middle income taxpayers, varying taxation on superannuation contributions ranging from 15% to 30% to 49% in various circumstances and varying tax rates applicable to superannuation and pension fund earnings.

The Henry Review considered superannuation and made numerous recommendations. We highlight some, not to suggest agreement, but to illustrate the complexity and interaction of many issues inherent in superannuation tax policy design:

> *"Recommendation 18: The tax on superannuation contributions in the fund should be abolished. Employer superannuation contributions should be treated as income in the hands of the individual, taxed at marginal personal income tax rates and receive a flat-rate refundable tax offset.*
> *a. An offset should be provided for all superannuation contributions up to an annual cap of $25,000 (indexed). The offset should be set so the majority of taxpayers do not pay more than 15 per cent tax on their contributions. The cap should be doubled for people aged 50 or older.*
>
> *b. An annual cap on total contributions should continue to apply.*
> *c. The offset should replace the superannuation co-contribution and superannuation spouse contribution tax offset.*
> *d. Compulsory superannuation contributions made by employers should not reduce eligibility for income support or family assistance payments. They should also not form part of the calculation for child support.*
>
> *Recommendation 19: The rate of tax on superannuation fund earnings should be halved to 7.5 per cent. Superannuation funds should retain their access to imputation credits. The 7.5 per cent tax should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams.*
>
> *Recommendation 20: The restriction on people aged 75 and over from making contributions should be removed. However, a work test should still apply for people aged 65 and over. There should be no restrictions on people wanting to purchase longevity insurance products from a prudentially regulated entity.*
>
> *Recommendation 21: The government should support the development of a longevity insurance market within the private sector….*
>
> *Recommendation 22: The government should consider offering an immediate annuity and deferred annuity product that would allow a person to purchase a lifetime income…*
>
> *Recommendation 23: The government should help make people more aware of the retirement income system, and therefore better able to manage their superannuation …"*

We accept that some fine tuning of the superannuation may be required, but we are concerned that the current heated debate risks excessive and inappropriate changes which will damage the savings environment in Australia.

Further, if action is not taken to analyse and assemble the full facts in a measured manner, the superannuation debate will distort the entire TRWP process.

General Business tax issues

The RDP outlines the high tax rates and high reliance on corporate tax in Australia's tax system.

In our view Australia's corporate tax collections and high level of integrity in our business tax rules show that the corporate tax system is not broken. That is not to say it might not be fine-tuned as discussed below.

International tax landscape

Australia's international taxation rules need continued fine tuning to deal with a changed global economy and to address base erosion and profit shifting. This should be done to the greatest extent possible through globally agreed reform and concurrent implementation. The alternative of uncoordinated action would be costly to Australia's growth and potential, if unilateral action were to result in double taxation imposed by Australia and other countries on the same income.

Australia's tax rules for international business have seen numerous policy adjustments and integrity rules including, since 2010:

- retrospective transfer pricing changes starting on or after 1 July 2004
- tighter general anti-avoidance rules
- new transfer pricing self-assessment and documentation rules
- tighter thin capitalisation rules
- changes to tax consolidation rules focused at foreign owned consolidated groups
- the new multinationals' anti-avoidance rule announced in the 2015 Budget.

These build on world-class controlled foreign company rules, which are tighter than those of most developed countries and which many countries do not have.

The changes already legislated need to be factored in to any business tax changes. A competitive international tax system is essential to complement our successful Free Trade Agreement strategy if Australia wishes to fully capture the opportunities arising from Asian growth.

A priority is that where Australian companies engage in desirable international expansion, the effective overall tax rate on underlying overseas income passed through to Australian shareholders is well beyond 60% in many cases. This undermines the worldwide competitiveness of our global groups, entrepreneurs and emerging Australian groups including family owned companies. This high tax charge creates a potentially unsustainable requirement for higher required overall return to create adequate after tax returns on equity. It may cause successful companies that are expanding overseas to seriously consider leaving Australia as a headquarters location.

Technology is also disrupting all areas of the business enterprise. Technological change provides opportunities for businesses to enter new markets and introduce new business and delivery models which can increase productivity and therefore fuel economic growth, as outlined in the Intergenerational Report.

The global BEPS initiative involves coordinated actions to deal with the technological change in business models, increasing reliance on automated processes, global supply chains as well as the value attributed to intangibles.

Protecting the tax base for Australia's tax system to address these challenges is important. However, a balance must be struck so that Australia's tax system also remains internationally competitive. This was identified in the Henry Review final report:

> *"The Australian economy is being transformed by the emergence of new centres of competition and opportunity in the region. The shift of the centre of gravity in the world economy towards Asia is reducing the distance between Australia and its export markets, adding considerable value to our natural resource wealth and opening new investment, trade and employment opportunities. However, growth in Asia will also attract globally mobile*

capital. Australia will need to respond if it is to remain an attractive place to invest and do business. Part of this response should be to ensure that the tax system supports investment, allocates resources to their most valued uses and does not inadvertently add to the cost of production through taxes on business inputs or excessive complexity and compliance costs…

Increasing capital and labour mobility will result in strong competition for capital, especially direct investment. Foreign direct investment in Australia as a share of GDP is low in comparison to many developed countries. The significant growth in the stock of foreign investment in Australia over the past 20 years has been largely in the form of portfolio equity and debt. This is likely to reflect our tax settings, at least to some extent."

We note also that technological change also allows tax authorities and governments to take advantage of the unprecedented transparency that comes with new IT techniques, to enhance efficiency of information collection and of tax compliance. But it is important for changed tax authorities' processes to be introduced collaboratively with business, with sufficient lead time to enable possibly significant IT and systems changes to be implemented smoothly by tax authorities and business. We emphasise the need to avoid or minimise making retrospective laws, or demands for information which has not previously been assembled by businesses.

Question 24 - Australian business and the global economy - How important is Australia's corporate tax rate in attracting foreign investment? How should Australia respond to the global trend of reduced corporate tax rates?

To help grow our economy, Australia needs to attract foreign investment, whether foreign direct investment into projects or portfolio investments into Australian businesses which may undertake their own investments. Australia represents broadly 2% of the world's GDP, but more than 2% of the world's landmass: domestic investment is not sufficient to develop our economy, opportunities and jobs for Australians and to maintain our position and significance.

Australia's tax rate is a relevant factor in foreign investment into Australia. In particular, the Australian tax rate on investments by foreign investors needs to be competitive. That means the effective taxes paid must be seen as not being excessive by comparison with other comparable jurisdictions.

Targeted incentives

We highlight one policy approach issue that should always be considered when attracting business investment – whether investment or local - in the tax policy mix.

Targeted tax incentives should be considered to a greater extent than recently, notwithstanding the challenging budgetary environment, to stimulate the desirable business capital investment which is currently lacking in Australia's economy.

Australia, like other countries, has a long history of using legitimate targeted incentives, designed expressly to facilitate direct new investments which contribute to the growth of Australia. Targeted investment incentives are well known in Australia, and have been used by Governments of all political persuasions.

Targeted investment incentives can be appropriately designed with integrity rules either built in or using the existing array of integrity rules including our general anti avoidance rule in Part IVA. They can be designed as targeted or short term stimulatory measures which expire after specified periods or to apply generally. Examples include:

- Investment allowances or bonus allowances for investment by businesses in specific units of tangible equipment, over and above capital allowances (depreciation). Investment allowances have ranged between 10% and 40% at various times
- Development allowances which are not tied to specific units of fixed assets (machinery) but are aligned to overall project expenditures. Development allowances were first introduced in 1992, in relation to projects certified and approved by appropriate regulatory processes.
    - Accelerated depreciation for particular categories of assets.

- Australia still has residual accelerated depreciation for some assets to enhance particular investments.
- Outright tax deductibility, instead of long term depreciation, is one type of accelerated depreciation. Australia has a long tradition of providing outright tax deductions for particular expenditures, as do many other countries.
- An excellent example is the current small business incentive, providing outright tax deduction instead of longer period tax depreciation for small businesses in relation to items of equipment costing less than $20,000. This has bipartisan support and the technique has been used by Governments of all persuasions.

- Incentives of this nature need not be linked to expenditure on hard assets such as equipment and buildings. The R&D incentive provided by various Governments is an example of an incentive which can be provided for designated expenditures, and confined to those segments.

Another category of targeted incentive is lower tax rates for particular types of business activity, to maintain competitiveness and attract investment. Australia has had less experience than some other countries of offering tax rate concessions for companies in particular sectors. We do note however:

- The lower withholding rate for distributions from managed investment trusts to residents of countries with whom Australia has tax information exchange agreements, introduced by the Labor government.
- Tax concessions for certain foreign investors into Australian venture capital funds.

The global BEPS initiative allows countries to offer tax concessions which are linked to substantial economic activity: such concessions do not conflict with the action to counter harmful tax competition by countries where there is no significant activity[9]. This confirms the legitimacy of this technique, used by developed and developing countries.

So we highlight for the TRWP process that the use of targeted incentives which:

- Focus on new investments, of designated sectors (the selection can be identified later)
- Include new investments in the development of intellectual property such as trademarks, copyrights, patents and know how (not just hard assets)
- Are designed with appropriate eligibility and integrity rules

provides real opportunity for enhancing growth in Australia.

Australian business, imputation and the global economy

Question 25 - Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open

Criticising imputation on the grounds that it subsidises domestic investment is a common position put by some. The Murray Financial System Inquiry (FSI) raised this as an issue to be analysed, in December 2014. We question these views.

The RDP notes the proposition that the marginal investor in Australian businesses (is the next investor) is likely to be a foreign investor. We question whether any or enough work has been done to support such a view in light of Australia's sizable and ever growing pool of domestic savings.

Imputation was analysed in the Henry Review. The CTA and EY joint submission[10] of April 2009 to the Henry Review stated, and we believe the comments remain relevant now:

[9] Action 5 Counter Harmful Tax Practices More Effectively, Taking into Account Transparency to tax authorities and Substance

[10] http://taxreview.treasury.gov.au/content/submissions/post_14_november_2008/CTA_and_Ernst_and_Young_Joint.pdf

“Dividend imputation system and competitiveness (consultation question 6.2)

Question 6.2 asks for input on changes to improve the effectiveness of Australian companies operating internationally, and options for integrating company and shareholder taxation. Our initial input was in section 2.2 of our 2008 submission.

The speech by Dr Ken Henry in February 2009[11], intended to stimulate discussion about the future of the imputation system, has resulted in various comments that the removal of dividend imputation would be the funding source for a drastic reduction in Australia's company tax system.

We provide further comments.

1. We agree that Australia should have a lower company tax rate, but there is not a choice simply between a lower company tax rate in Australia (scrapping dividend imputation) and retaining dividend imputation in its present form. It is possible to retain an imputation system in Australia and to also reduce company tax rates over time. The funds for tax rate reductions can emerge from tax mix adjustments, the economic benefits of a more efficient tax system and reviewing outlays. We suggest that a more attractive tax environment would see additional economic activity in Australia, although the extent of such improvement is difficult to forecast. As well, we wonder if the simple "either lower tax rate or imputation" analyses consider the need for tax incentives for savings and capital income which are identified by the Review.

2. The imputation system is clearly an impediment to Australian companies which seek to remain headquartered in Australia with Australian investors, and invest overseas. This is recognised in Dr Henry's speech. This disincentive effect can be remedied without requiring the elimination of the dividend imputation system which has, since its introduction in the mid 1980s, provided a significant incentive to invest in Australian companies and has enhanced capital formation and savings in Australia.

That disincentive feature of the imputation system could be rectified in various ways:

a) *One remedy, proposed in the Board of Taxation 2003 report into Australia's international tax arrangements, is to provide a partial imputation benefit in relation to foreign sourced income which is included in dividends paid to Australian shareholders. This was not adopted at that time by the Federal government pending other international tax reforms, but was not rejected outright.*

b) *Another solution would be to permit some dividend streaming mechanisms, to enable certain foreign income of Australian companies to be streamed to foreign shareholders. A similar proposal was put forward in a consultation document in New Zealand, published in August 2008.*

c) *A third approach would be to reduce the differential tax outcomes for investors in relation to dividends sourced from domestic fully-taxed income as compared with foreign income. For example, if partial franking credits or tax benefits were provided to Australian investors for all their dividend income from Australian companies irrespective of the source of the profits of the Australian companies, the disadvantages of global expansion by Australian-based companies would be reduced.*

3. There may be reasons for Australia to move away over time from the imputation system, given that it has largely been eliminated in the European Community due to EC political requirements. If so, it is critical that Australia does not revert to the classical system of underlying company income being double-taxed, once in the company and again in the shareholder's hands without tax relief.

[11] "A tax system for Australia in the global economy" - Speech by Dr Ken Henry, Australian Business Tax Reform in Retrospect and Prospect colloquium, Sydney, 23 February 2009

A reversion to a classical double taxation system without concessional treatment of dividends in shareholders' hands would cause major disturbance to Australia's capital markets and Australia's savings patterns with a major impact on the ability of Australian companies to raise their capital from Australian investors.

So, any changes to the dividend imputation system would need to ensure that investment by Australian investors in Australian companies remains attractive and would need to be clearly signalled to Australian investors and the stock market, with sufficient lead time to understand the impact for Australian companies.

4. We highlight that this is not an issue just for listed companies. Private companies and their shareholders need an integrated tax system. This can be achieved for private companies, if not through an imputation system, by a flow through taxation system for private companies as has been suggested to the Review.

5. If Australia were to move away from the current dividend imputation system, an integrated or concessional treatment of company and shareholder taxation can be achieved over time in various ways including:

a) tax concessions to investors for their dividend income from companies, an approach used for example in the US (with lower tax rates on dividends) and the UK (with automatic de facto franking on all dividends).

b) other mechanisms for the concessional treatment of capital income more generally, adjusted to take account of the needs of companies. The Review is commissioning research on various such mechanisms, such as business expenditure taxes including ACE (allowance for corporate equity) and cash-flow taxes, as noted in Appendices D and E of the consultation paper, which are expected to be discussed in more detail in the June 2009 tax policy conference organised for the Review.

We do not comment on these alternative mechanisms in detail. We note that, after the June conference is held, we might provide further input to the Review and seek discussions in relation to this issue.

In February 2015, the issues for analysis were noted in a presentation by Rob McLeod, New Zealand Chairman, EY, following the FSI report[12] . The issues include:

If the marginal shareholder setting the price of Australian equity is a foreigner who does not receive any benefit from imputation, that means the quantity and price of Australian equity is unaffected by dividend imputation. But the foreign marginal shareholder observation in respect of all equities implies a share held by a foreigner sets a reference market price for all shares in Australian companies. ***That would seem a very questionable proposition across all companies and markets, such as unlisted markets****.*

The ***FSI in its comments on dividend imputation does not set out any alternative scheme of company taxation****. Because the classical double tax system is the international norm, it is the usual benchmark against which imputation is compared.*

Some foreign shareholders do benefit from imputation *because franked dividends are exempt Australian non-resident withholding tax (NRWT), whereas unfranked dividends are not…*

Imputation motivates Australian companies to substitute Australian tax for foreign tax *since foreign tax does not qualify as a franking credit. This gives Australian companies an incentive to transfer price foreign income from outside Australia to Australia in order to substitute Australian tax for foreign tax. That dynamic benefits Australia which is a benefit that is not weighed in a marginal foreign shareholder analysis.*

Imputation also tends to mitigate tax induced differences between choosing an unincorporated or corporate entity as an economic vehicle in a domestic setting.

[12] *The Murray Review Through a Tax Lens, Rob McLeod, New Zealand Chairman, EY, to the 2015 Financial Services taxation Conference, The Tax Institute, Feb 2015*

> *"Critics of imputation sometimes argue that a classical company tax system would enable the revenue loss from imputation (or put another way, the additional tax shareholder tax under classical) to fund a lower company tax rate. This may be one reason why OECD company tax rates under a classical system have been historically lower than those under an imputation system. In those cases where foreigners are marginal investors in Australian companies, a lower company tax rate would also increase the quantity of inbound investment.*
>
> *These arguments were considered by the NZ Capital Market Development Taskforce in 2009. It concluded that* ***once likely behavioural changes to dividend paying behaviour was taken into account, moving from imputation to a classical tax system would fund only a very modest reduction in the company rate of around 2 percentage points unless complex and distortionary excess profit retention provisions were also introduced.*** *It would also reintroduce the debt/equity biases that imputation was designed to remove. The Taskforce concluded that a switch from imputation to a classical company tax system was undesirable."* (EY emphasis added)

So we do not suggest dismantling Australia's dividend imputation system. The dividend imputation system has served Australia well, including by:

- reducing the duplication of taxes between companies and their shareholders in relation to domestic activities, thus tending to reduce the debt levels of Australian companies
- resulting in the strong growth by Australian investors of investment in Australia's capital markets, which has strengthened the Australian economy
- providing strong incentives for the payment of Australian company tax by Australian companies.

While retaining the imputation system, there is scope to improve the system and its inbuilt bias against Australian business' international engagement. We respond to the RDP questions below.

Questions 32 and 33 - Improving the recognition, in our imputation system, of foreign income so as not to distort investment decisions

We agree with Treasury, the Reserve Bank and Treasurer Joe Hockey that opportunities that arise for Australian businesses, small and large, servicing the needs of the rising middle class in Asia, as well as the rest of the world. Free trade agreements are part of the Government's successful strategy to improve access to these markets for Australian companies.

It is in Australia's national interest to see Australian technology and know-how owned in Australia and based in Australia while being used internationally to the advantage of Australia's economy, for Australian jobs to be created via the ongoing growth and development of Australian headquarters of global companies, with employment opportunities directly within these companies as well as in related service activities.

Australia has moved beyond being a pure capital importing country and our businesses are moving from a principally domestic focus to investment overseas. As Australia represents approximately 2% of global economic activity, Australian businesses must expand overseas to fully develop their business operations and gain scale.

It is important that Australia's international tax settings do not undermine the competiveness of Australian companies and allow Australian companies to capitalise on these opportunities from their home base. It is important that the settings for imputation allow retaining such Australian incorporated companies and their employment in Australia.

On current tax policy settings, foreign income earned by Australian companies that is distributed to Australian shareholders is subject to excessive taxation. The effective tax rate on underlying overseas income passed through to Australian shareholders is well beyond 60% in many cases. This undermines the worldwide competitiveness of our global champion companies and emerging Australian groups, including family owned companies alike.

A recommendation to examine this problem appeared in the Ralph Review in 1999.

The Board of Taxation reviewed this issue in its 2003 Review of International Taxation Arrangements[13]. The Board recommended that Australian companies operating offshore and subject to offshore taxation should, when they pay dividends to Australian shareholders, be permitted to provide shareholders a partial non-refundable imputation benefit by way of a 20% franking offset.

> ***"Attracting equity capital for offshore expansion - Recommendation 2.1(1)***
> *The Board recommends:*
> *(a) that domestic shareholder tax relief should be provided for unfranked dividends paid out of foreign source income derived after the commencement date; and*
> *(b) that the relief should be provided by way of a non-refundable tax credit of 20 per cent and without any requirement to trace foreign tax paid or incurred."*

Importantly, the Board:

- Did not recommend winding back of the imputation system for Australian companies or investors
- Saw this as a partial recognition of the internationalisation of Australian companies

That recommendation did not eliminate the incentive for Australian companies to pay taxes and focus on Australia. As outlined in the BCTR/EY Study published in 2007 [14], when this proposal is compared with the taxation outcomes which would arise from a fully refundable imputation credit of 30% for Australian income, there is still significant Australian tax imposed on Australian residents who receive dividends attributable to foreign income.

However, the recommendation enables the imputation system to be better reconciled with the need for Australian firms to engage more strongly internationally.

We highlight also that looking at how other countries deal with the international investment issues, the reforms have reduced the effective tax rates on dividend income in absolute terms. This has occurred even if reforms in other countries generally have not been confined to dividends sourced from foreign income. The enhanced neutrality of the taxation of capital has encouraged the efficient deployment of these nations' capital and savings. As examples:

- New Zealand has reduced its corporate rate. It has an imputation system like Australia which neutralises this reduction from a total tax outcome. However, New Zealand's top marginal personal tax rate is set at 33% creating more competitive overall outcomes

- Germany combines a foreign dividend exemption on corporate level with a flat 26.4% tax rate on dividends received by the ultimate shareholders. The German rate on income from capital is still high by international standards but is almost half the Australian top marginal tax rate.
- A study by EY in Sweden [15] suggests that the average tax rate on dividend income in the hands of a shareholder across OECD, EU and BRIC is around 20%.

We submit that there should be a sense of urgency to review and improve Australia's international tax policy settings for non-portfolio outbound investments for the reasons outlined above. This will allow and encourage Australian companies to remain in Australia whilst creating a meaningful international footprint.

[13] http://www.taxboard.gov.au/content/content.aspx?doc=reviews_and_consultations/international_taxation_arrangements/default.htm&pageid=007

[14] BCTR and EY Submission to Treasury, "International Tax Reform - Removing double taxation of Australian companies which operate internationally", page 45 with detailed analysis in the appendix

[15] Robert Carroll and Brandon Pizzola (Ernst & Young LLP United States) and Erik Hultman and Martin Segerström (Ernst & Young AB Sweden); Corporate Dividend and Capital Gains Taxation: A comparison of Sweden to other member nations of the OECD and EU, and BRIC countries; October 2012, Page1

Question 26 Mutual recognition of imputation credits between Australia and New Zealand

Creating more integrated and efficient Trans-Tasman capital markets is certainly in line with both Australia's and New Zealand's aspiration to remain competitive with other regional economic centres and with the goal of creating a single economic and investment market to expand the pool of investors from which capital can be sourced.

Trans-Tasman mutual recognition (TTMR) of imputation credits is a sound economic policy to consider.

A joint study by Productivity Commissions of Australia and New Zealand (NZ) shows how the cost of capital would be reduced as equity returns would no longer carry the tax inefficiency from double taxation.

One relevant issue is the precise cost to the Australian Federal Budget. We understand, however, that the NZ Treasury and other agencies have commissioned recent modelling which shows much smaller costs than previously publicly reported.

As well, however, there will be second round (dynamic) tax revenue effects. TTMR will change the capital flows between Australia, NZ and the rest of the world. TTMR alters the expected returns to Australasian equity investments, which will change capital allocation decisions within Australasia and between Australasia and the rest of the world. We suggest that both Australia and NZ would materially benefit from adopting TTMR.

Question 39: Does the R&D tax incentive encourage companies to conduct activities that would otherwise not be conducted in the absence of government support? Would alternative approaches better achieve this objective and, if so, how?

Recent experience in Australia and globally points to the effectiveness of tax incentives in supporting and nurturing R&D as part of an innovation ecosystem.

A November 2014 European Commission study of R&D Tax Incentives[16] found that "The vast majority of studies surveyed in this report conclude that R&D Tax Credits are effective in stimulating investment in R&D". This report surveyed R&D Incentives across 33 countries, including Canada, Israel, Japan, Norway and the United States, in addition to members of the European Union.

The report also assessed what is good practice in R&D incentives and concluded:

- "volume-based tax credits are preferred over incremental ones …
- tax incentives should only be aimed at R&D activities that are likely to contribute to the world-wide stock of knowledge, rather than support activities limited to the advancement in firm's own state of expertise …
- as R&D expenditure may precede revenue generated by innovation by several years, it is good practice to provide a carry-over facility and an option to receive the benefit even in case a company is not profitable (cash refunds)".

These are all existing qualities of the R&D Tax Incentive legislation in Australia.

There is also evidence that constant alteration of R&D incentives reduces their effectiveness.

[16] European Commission "A Study of R&D Tax Incentives" - http://ec.europa.eu/DocsRoom/documents/8032/attachments/1/translations/en/renditions/native

The OECD report "Maximising the benefits of R&D tax incentives for innovation"[17] states:

> *"OECD analysis … suggests that in countries that have experienced a large number of R&D tax policy reversal, the impact of R&D tax credits on private R&D expenditure is greatly diminished. **It is therefore important that governments do not repeatedly tinker with such policies to minimise policy uncertainty for firms**"* (EY emphasis added).

A reasonable conclusion from this research is that the current R&D Tax Incentive legislation:

- can reasonably be expected to change behaviour by encouraging investment in R&D;
- exhibits many qualities that can be viewed as world's best practice in R&D tax incentives; and
- its effectiveness in stimulating such investment would be compromised by further change.

It is important to recognise that there are additional benefits to Australia's broader internal and international competitiveness as a nation.

R&D investment has also been shown to enhance technology transfer (that is, "absorptive capacity") by facilitating the imitation of the discoveries and inventions of others. By actively engaging in R&D, workers acquire knowledge and skills enabling them to more easily understand and assimilate the discoveries of others.[18] This represents an often underappreciated benefit of R&D tax incentives.

A survey of the Australian R&D Tax Concession system conducted by the Department of Industry Tourism and Resources[19] focused on the concept of "behavioural additionality". The Department considered the difference in firm behaviour resulting from government intervention, which included both long term effects on company behaviour and short term impacts. The research concluded that government subsidies have impacts extending well beyond a single project and traditional input-output evaluations do not fully measure for these effects.

Accordingly, the R&D Tax Incentive does achieve greater benefits to the wider innovation ecosystem that may often be difficult to quantify or measure. The R&D Tax Incentive regime's strength lies in its ability to enable a broad base of innovation intensive companies to continue to promote and stimulate investment across the Australian and global competitive landscape.

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

As discussed above, there is evidence that constant alteration of R&D incentives reduces their effectiveness. One of the key concerns with government support of innovation is to ensure that its effectiveness is not diminished by overly complicated or administratively burdensome approaches.[20] Broad-based programs which allow businesses to make a decision about their own R&D, and have clear guidelines (based on law) are a great way to achieve this, as indicated in a recent OECD study:

> *"Clarity, consistency and predictability are essential to assist enterprises in making R&D Investment decisions partly on the basis of tax Incentives".*[21]

[17] OECD report on innovation tax incentives reform, 11 October 2013. http://www.oecd.org/sti/rd-tax-incentives-for-innovation.pdf

[18] "Mapping the Two Faces of R&D: Productivity Growth in a Panel of OECD Industries.", Griffith, R., Redding S., Van Reenen, J., 2004, The Review of Economics and Statistics, vol. 86, no. 4, pp. 883-895.

[19] "How R&D Assistance Influences Company Behaviour", Department of Industry Tourism and Resources, Canberra. http://www.industry.gov.au/innovation/reportsandstudies/Documents/HowRandDAssistanceInfluencesCompanyBehavior.pdf

[20] "Achieving innovation and global competitiveness through research and development tax incentives: lessons for Australia from the UK." McKerchar, M., Hansford, A., 2012, 24th Annual Conference of the Australasian Tax Teachers Association, Sydney.

[21] "Tax Incentives for Research and Development: Trends and Issues", OECD < http://www.oecd.org/dataoecd/12/27/2498389.pdf>.

Programs which involve direct or discretionary support can often become administratively burdensome to both Governments and applicants, and can diminish the effectiveness of any incentive programs.

Additional taxation incentives that may be appropriate to assist in encouraging investment in innovation and entrepreneurship are described below:

- **Increased frequency of cash payments for small businesses:**
  One weakness in the current 45% refundable offset legislation is the time delay between the expenditure being incurred and the R&D refund being obtained. Such a refund is only available on an annual basis, via a company's tax return, which can result in a delay between initial expenditure and the resultant refund of over 12 months. The ability to access refundable R&D tax credits more frequently would provide timely access to cash flow for SMEs that are in early stages of development, and often have modest cash balances.

- **Preferential rates for R&D salary expenditure:**
  It is widely recognised that one of the key challenges faced by Australia is boosting productivity and skills utilisation in Australia and that strong and innovative organisations play a key role, acting as both a 'trigger' and 'enabler' of skills utilisation.[22] Employment and engagement of skilled researchers, including scientists, engineers, or other qualified research staff could be encouraged by offering a higher R&D Tax Incentive rate to expenditure incurred on R&D related salaries.

- **Preferential rates and eligibility for Research Service Provider expenditure:**
  Activities undertaken by such institutions are largely at the leading edge of current knowledge, so defining activities conducted with these organisations as "eligible R&D", within the existing self-assessment system, would encourage more research to be conducted at these institutions, as well as reduce the administrative burden on companies who are claiming R&D Tax Incentives for such activities. This would directly help to support one of the key priorities of the *"Boosting the Commercial Returns from Research"* strategy by encouraging collaboration between business and public research institutions.

- **Encourage superannuation funds to invest in R&D:**
  This would potentially unlock a whole new source of funding for investment in innovation within Australia, and support significant ongoing development within our society. This could be achieved with modifications to the eligibility requirements of existing programs, such as the R&D Tax Incentive and VCLP (Venture Capital Limited Partnerships) programs.

Question 42 - Options for small business including flow through entities

The consideration of an alternative small business flow through structure is welcome. An alternative which would help decrease the complexity and costs in choosing and establishing a small business structure is a desirable aim for the sector that should further support and encourage business.

However, the development of an alternative will also need to consider how the needs of family and other closely held businesses for flexibility can be accommodated.

A reduction in complexity and costs in choosing, establishing **and operating** a small business structure might also be achieved through appropriate reform of the current tax system. In this respect we note:

- we are still waiting for the recommendations of the Board of Taxation and for the Government's response to its review of the Division 7A private company loan provisions. A number of recommendations responding to the issues raised in the Board's paper and in consultation might address a number of key complexities in the law for small business.
- the previous Government's review of the outdated Division 6 of the 1936 Tax Act trust tax provisions might also have led to appropriate reforms to the benefit of small business as part of

[22] "Better use of skills, better outcomes: A research on skills utilisation in Australia", April 2012

the proposed re-write of that regime. It may be worthwhile for that process to be resurrected under this Government.

The ability to move between structures without unnecessary and punitive tax costs as a business moves through the various stages of its lifecycle is also desirable. We welcome the recent Government announcement to extend tax rollover relief for small businesses in certain circumstances. There should also be the ability to move in and out of a new small business structure without a tax cost where there is no change in the ultimate owners of that entity. Continuity could also be met where no new owners commence to control that entity.

As with all regimes intended to be concessional, a balance will need to be struck between protecting the integrity of the rules and meeting the principles of simplicity and low compliance costs. This might be managed by tightly targeting the rules to small business owners and their families rather than relying on complex integrity rules to do this work.

An entity similar to a "S-Corporation" and with limited liability and other features as set out broadly in the RDP would likely appeal to some small businesses but not to all. This could allow flexibility for family groups under this approach: but it would not replace all current structures. That limited scope should not be a barrier to its potential development if it would otherwise have broad potential application.

The need to understand the structure and its tax and other legal consequences will still result in start-up costs for businesses which are unavoidable but may be constrained if the tax and other requirements to qualify and operate under that structure are likewise constrained.

Employment taxation

1. Question 6 - Fringe benefits tax

Fringe benefits tax (FBT) was introduced into Australia's tax system thirty years ago and has not been subject to a wholesale review since. Currently, the incidence of FBT is largely borne by employers.

FBT has grown significantly in complexity due to the introduction over time of grossing up, GST, the reportable benefits regime which affects individuals' income-tested benefits and obligations, and broad-based salary sacrifice regimes, none of which were contemplated when the law was first written. This has led to a multi-layered system whose underlying structure was not designed to enable the many purposes now served.

Two fundamental concerns exist with the operation of the current FBT system:

- the inequity caused by the application of tax at a rate equivalent to the highest marginal tax rate and
- the significant administration costs associated with complying with the FBT, which is a comprehensive and highly prescriptive tax.

There are also a number of concessions that are made available under the FBT targeted at specific situations or specific taxpayers that may no longer be appropriately targeted.

Therefore, we query whether the initial policy intent behind the introduction of the FBT is relevant for today and the future tax system in Australia.

We consider that the transfer of tax collection from FBT on the employer to income tax on the employee, shifting the tax burden from employers to employees, would not of itself resolve the two fundamental concerns, as it would to a significant extent, simply require the replication of current FBT rules into the personal tax system. These two concerns are best addressed by alternate targeted measures. We also note that any move to shift the incidence of taxation from employers to employees would likely result in significant disruption to remuneration negotiation processes.

We therefore recommend the Government undertake a holistic review of the FBT to assist it to articulate a policy position on the taxation of fringe benefits. In doing so, particular attention should be paid to the FBT concessions available and whether the right entities are accessing the right concessions. This will require the Government to revisit the original policy intent behind FBT to ensure that this is still relevant in the future of the tax system. As such, the Government will need to assess whether FBT is still achieving its intended purpose and to consider whether this intended purpose is still appropriate today. The Tax White Paper process provides an appropriate opportunity for this review to take place.

Should the Government consider a more dramatic overhaul of FBT, we recommend the NZ system be closely examined as a possible framework for Australia. Such a change could allow for fringe benefits to be taxed at marginal rates commensurate with an employee's marginal rate. This would go some way to addressing the inequity in the current system of applying an equivalent of the highest marginal rate only. A reduced number of benefits subjected to FBT would also significantly ease administration. However, a change of this magnitude has some obvious real challenges that should not be ignored, including revenue losses.

Any proposed change to FBT would have to address the extensive administration burden arising from complying with it. A proposed change to FBT would not be satisfactory unless the overall administrative burden was reduced, contributing to simplification in the system. This would involve:

- simplification of the valuation rules,
- a reduction in the number of declarations required to be made
- the introduction of safe harbours
- streamlining the process by removing multiple gross-up rates and
- introducing safe harbour type methodologies to allocate benefit values to employees without specific tracking at individual level below certain values.

We reiterate that we strongly recommend that a holistic review of the FBT system be undertaken first, prior to any other radical changes to the FBT system taking place.

2. Review 2012 living away from home (LAFHA) changes

Recognising that implementation of any changes from a broad ranging review of FBT would not take place for some time, there is a need for a more urgent review of one particular area of the FBT rules.

Changes were made to the operation of the LAFHA provisions in 2012. Whilst it is recognised that changes were needed, we consider that the changes went too far and are now seriously hampering Australia's competitiveness, both from the point of view of inbound investment, as well as Australia's ability to export services, an area that should be one of this country's strengths.

Additional FBT costs imposed by the LAFHA rule changes are seriously affecting the ability of Australian companies who wish to use Australian based employees to provide export services to provide those services competitively. It is also making it more costly to attract skilled labour to Australia, thus adversely impacting the trend towards increasing labour mobility.

Put simply, the 2012 changes mean that Australian employers, seeking to post employees overseas for short to medium postings, find that legitimate LAFHA costs are ineligible for concessional treatment and attract FBT. This makes posting of Australian employees overseas very costly and restricts the implicit export of Australian services. Conversely, the treatment of short to medium term postings of foreign employers into Australia becomes hugely costly. These are not scenarios involving abusive gaming of the concessions by high income top level executives – the situations relate to lower level employees posted for short to medium terms.

3. Abolish employment cessation taxing point under ESS rules

The employee share scheme (ESS) rules have one significant inequitable feature that causes difficulties when, in today's more flexibly economy, people must leave one employment on retirement or as part of their working life involving moving to other employment.

Currently a taxing point under the ESS rules is when the employee ceases employment.
The taxing point under the ESS rules at cessation of employment is contrary to the objective of aligning the taxing point with when an employee can realise value from the ESS awards. Further, the incentive to accelerate vesting is a result that is contrary to good corporate governance principles.

These objectives have been recognised to some extent in the recent proposed amendments to ESS rules. However, they do not address the issue of tax at employment cessation. Australia remains out of alignment with most countries in its approach to taxing equity awards when an employee ceases employment, with significant adverse consequences to individuals in having to fund tax liabilities in respect of benefits they have not yet received and may never receive.

We recommend that the reporting and withholding mechanisms at termination of employment be strengthened to ensure that awards that ultimately vest are appropriately recognised, but that the taxing point at cessation is removed. We note that this is consistent with the recent Productivity Commission draft report which looks at the key drivers of business set-ups, transfers and closures.

4. Superannuation guarantee

The superannuation guarantee regime is complex and difficult to administer consistently. This is an instance of loading costs onto employers from over-regulation and inefficient rules.

The regime could be significantly improved by addressing contentious issues such as:

- the definition of “overtime”
- the treatment of non-standard payments such as payments in lieu of notice
- maximum statutory requirements in the form of the maximum contribution base apply on a quarterly basis which does not align with the frequency of most payrolls. The maximum contribution base should be a monthly limit to allow employers to readily reconcile their obligations.

Not for Profits (Chapter 7)

Many organisations in the NFP sector will be concerned that NFP tax concessions are a focus of the RDP, in particular its focus on the revenue costs of the various tax concessions (as opposed to the benefits provided by the sector) and that it also raises concerns about competitive advantage vis a vis "for-profit" organisations.

Similar issues were raised (and responses thereto were provided) in the Henry review and, more recently, by the NFP Sector Tax Concession Working Group. Many NFP groups devoted significant resources through the submission and consultation process with a view to not only maintaining access to the existing tax concession regime, but to also provide suggestions on how the tax concession regime could be expanded to further assist delivery of benefits to the Australian community.

Subsequent events have seen the Government release the Final Report of the Competition Policy review. The NFP sector will point to the fact that the Final Report's 56 recommendations do not raise any issues relating to concerns about NFP competitive advantage.

The Government has acted, in the 2015/16 Federal Budget, to announce a proposed specific change to the Fringe Benefits Tax legislation which will effect NFP organisations from 1 April 2016. These changes are likely to have a significant impact on NFP recruitment and cost management as employees of NFP organisations will no longer be able to salary package certain benefits and a grossed-up cap of $5,000 will apply for salary sacrificed meal entertainment and entertainment facility leasing expenses (e.g. holidays, hotels, cruises, weddings) in addition to existing caps (affecting both exempt and rebatable employers).

In light of all those developments, we see little merit in yet another review of NFP tax concessions in relation to any perceived competitive advantage issues.

GST, State Taxes and Indirect Taxes (Chapters 8 and 9)

It is clear from the statistics assembled in the RDP that Australia has opportunities for increased indirect taxation, and the tax mix is skewed towards taxation of individuals and companies. Even ACOSS accepts the scope for some reform here.

We recognise that increased indirect taxation by way of GST or other taxes will involve questions of providing compensation to low income taxpayers.

However, we re-emphasise the statistics which are presented at table 3.2 of the RDP, that Australia's lowest income taxpayers do not in fact pay significant tax, and the individual income tax is overwhelmingly paid by the middle to high income taxpayers. Australia's tax rates are highly progressive, a driver of higher equality of incomes (or lower inequality) than in many countries. That table shows that, in the latest year for which comprehensive statistics are available:

- 18.3% of individual taxpayers have incomes $16000 or less and pay no personal income tax
- Taxpayers with $16001-37,000 of income are 27.3% of taxpayers but pay only 3.7% of individual income tax
- Individuals earning $80,001-$180,000 are 14.5% of personal taxpayers but pay 26.1% of personal tax
- Taxpayers earning over $180,000 of income are only 2.3% of the taxpayer population but pay 26.1% of personal tax collections

As a result the development of appropriate compensation arrangements for truly low income taxpayers should be achievable.

We recognise also that the development of indirect taxes, and in particular GST, is subject to Commonwealth and States discussions and agreement. We urge both the Commonwealth and States to collaboratively develop proposals for consideration by the Australian public.

Complexity and administration (Chapter 10)

The Government's progress on working through the work program to deal with the backlog of announced but unlegislated measures has provided greater certainty for businesses. We commend this initiative.

However, ensuring that measures are legislated soon after announcement should not come at the expense of providing enough lead time to consult and for taxpayers to implement the measures, in particular with tax laws becoming increasingly complex and often involving significant investment in systems (for example, information exchange initiatives such as the Foreign Account Tax Compliance Act (FATCA) reforms and the upcoming Common Reporting Standard (CRS) changes which affect financial institutions).

An example of a major change where taxpayers were provided with an appropriate long lead time with great benefit was the consultation process on the New Tax System for Managed Investment Trust (MIT) draft law released in April 2015. Consultation on these measures commenced almost five years beforehand in 2010. The reform is also proposed to commence from a prospective start date rather than retrospectively from the date of announcement, with appropriate transitional rules, to provide taxpayers with sufficient time to implement the measures.

Allowing taxpayers sufficient lead time prevents complexity. For example, the measures proposed for taxation of not-for-profits' unrelated business income which were announced in the 2009 Budget, with a start date from Budget night, were impossible to implement as there was not enough lead time to resolve uncertainty and ambiguity around the definition of 'unrelated commercial activities', despite multiple deferrals of the start date of the measures. This drove the decision of the Government not to proceed with those measures.

Further, we believe that complexity and uncertainty can be better resolved by providing regulatory bodies such as the ATO, with more discretionary powers to resolve matters efficiently.

We support the 1 May 2015 announcement by Assistant Treasurer Josh Frydenburg that the Government will provide the Commissioner of Taxation with a statutory remedial power to allow for a more timely resolution of certain unforeseen or unintended outcomes in the taxation and superannuation law.

Question 58 - System-wide approaches with impact on reducing complexity in the tax system - Why have previous attempts to address complexity in the Australian tax system not succeeded? How might it be done in a way that is more successful?

We are concerned about the complexity of the Australian tax system. There is merit in a detailed review of the scope for Australia's tax law to be expressed in a more concise and commercial manner than has been the case previously.

Australia's tax system is characterised by a high volume of drafting, lengthy legislative provisions, requiring amending legislation when the initial formulation of words (even if developed in a consultative process) does not meet all of the circumstances in which business and taxpayers operate.

The complexity has arisen for a number of reasons including:

- A desire on the part of the ATO, particularly in the past, to have black letter law covering all scenarios arising from an ATO perception that its tax administration power was limited
- A lack of confidence on the part of taxpayers that the ATO in its administration of the law would be commercial and realistic, causing their desire to have all possible concessions and areas of uncertainty clarified in 'black letter law'
- A desire on the part of Treasury to develop high quality, fully articulated, law but which unfortunately led to overly prescriptive law with a huge volume of words and explanatory memoranda
- A perception that courts require highly detailed law in order to carry out their function.

The problems arising from the previous approaches have now been recognised and we note that:

- Treasury is reviewing for example various measures such as the taxation of financial arrangements and indeed tax consolidation to identify more effective ways of implementing those laws and refining those laws.
- The Government has announced that the Commissioner of Taxation will be given a statutory remedial power to cover gaps in legislation in favour of taxpayers
- The penalty environment means that in some cases taxpayers taking reasonably arguable positions are less exposed to penalties than what was previously the case.

Treasury has considered some years ago the potential for greater use of principle based drafting when introducing new tax legislation. We think that this has not been examined in the tenure of the current Commissioner of Taxation, Mr. Chris Jordan, and his team.

We support a detailed examination, arising from this TRWP process, of the scope for adjusting Australia's legislative approach to taxation including the possibilities of:

- Shorter legislation with a greater focus on regulation
- Principle based legislation with a capacity for modifications to be developed in various ways including regulations (the US approach) or Tax Office guidance (one direction adopted in the UK).

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