



# **Submission to the Tax White Paper Task Force**

**1 June 2015**

1 June 2015

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

**By email:** [bettertax@treasury.gov.au](mailto:bettertax@treasury.gov.au)

Dear Taskforce Members,

**Re: think Tax Discussion Paper**

Deloitte welcomes the opportunity to provide a submission on the Tax Discussion Paper. The following addresses some, but not all, of the questions raised in the Tax Discussion Paper. Our comments around tax reform are grounded in a view as to the role of taxation as being a key prosperity driver for our society.

- From an economic perspective, societies have two main aims – prosperity (the size of the pie) and fairness (how that pie is sliced up)
- A better tax system can contribute to both aims, but is especially well positioned to boost prosperity
- That is all the more important because the current decade is seeing retirement among baby boomers and falling commodity prices, meaning that a lift in productivity growth is central to Australia's future prosperity
- At the same time both Treasury and Deloitte Access Economics have been changing their estimates of the extent to which different taxes weigh on prosperity. The resultant rising gap between 'good' and 'bad' taxes suggests that a substantive tax reform package could add some 2% to national income
- If achieved, that would rank among the largest reforms ever implemented in Australia
- However, the Budget backdrop to the current reform process is challenging – meaning that not only is tax reform more needed and potentially more valuable than ever, but also that it will be particularly hard to smooth the way for much needed tax reforms by making them less than revenue neutral

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/au/about](http://www.deloitte.com/au/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Liability limited by a scheme approved under Professional Standards Legislation.

- Importantly, however, the nation has a number of options open to it. Past taxation reviews remain relevant and continue to be a useful blueprint for the design of the tax system
- Many of our current tax arrangements work efficiently, are widely accepted as good policy, and only require minor adjustments. However, it is clear that we could do better, and major reforms could achieve an overall outcome of a more productive, prosperous economy.

We would be pleased to discuss any aspect of this submission.

Yours sincerely



**David Watkins**  
Director  
Deloitte Tax Services Pty Ltd  
02 9322 7251



**Chris Richardson**  
Partner  
Deloitte Access Economics  
02 6175 2089



**Vik Khanna**  
Director  
Deloitte Tax Services Pty Ltd  
03 9671 6666

# Contents

<b>1</b>	<b>The economic backdrop to tax reform</b>	<b>5</b>
	The growth in Australia's prosperity is under challenge	5
	Taxes have a big impact on prosperity	6
	Spending has a bigger impact on fairness	6
	All taxes distort economic activity in some way	6
	Treasury estimates of the potential gains from reform have risen	6
	The Budget backdrop is challenging	8
<b>2</b>	<b>Tax reform process</b>	<b>8</b>
<b>3</b>	<b>Corporate tax rate</b>	<b>8</b>
<b>4</b>	<b>Imputation</b>	<b>9</b>
	Retaining dividend imputation	9
	An alternative system?	9
	Reforming dividend imputation	9
<b>5</b>	<b>GST</b>	<b>10</b>
<b>6</b>	<b>Superannuation</b>	<b>11</b>
	Objectives of a superannuation system	11
	EET or TEE?	12
	Taxation of contributions and contribution caps	12
	Earnings rate	13
	Taxation of benefits	13
	Preservation and adequacy	13
	Certainty and confidence	14
<b>7</b>	<b>Tax Treatment of outbound and inbound investment</b>	<b>15</b>
	Anti-deferral (CFC) rules	15
	Interest expense	15
	Sovereign Immunity	15
<b>8</b>	<b>The tax treatment of risk taking: Losses</b>	<b>15</b>
<b>9</b>	<b>Revenue versus capital</b>	<b>16</b>
<b>10</b>	<b>Innovation</b>	<b>16</b>
	Existing R&D regime	16
	Other incentives	16
<b>11</b>	<b>CGT discount and negative gearing</b>	<b>17</b>
	CGT discount – rate	17

	CGT discount – scope	17
	Negative gearing	17
<b>12</b>	<b>Fringe Benefits Tax</b>	18
	Fringe benefits tax versus taxed to employees	18
	Reforming the fringe benefits tax system	18
<b>13</b>	<b>Tax settings for Not-for-profits</b>	18
<b>14</b>	<b>State government taxes</b>	19
<b>15</b>	<b>Personal tax returns</b>	19

# 1 The economic backdrop to tax reform

## The growth in Australia's prosperity is under challenge

There are only three real drivers of Australia's living standards – either:

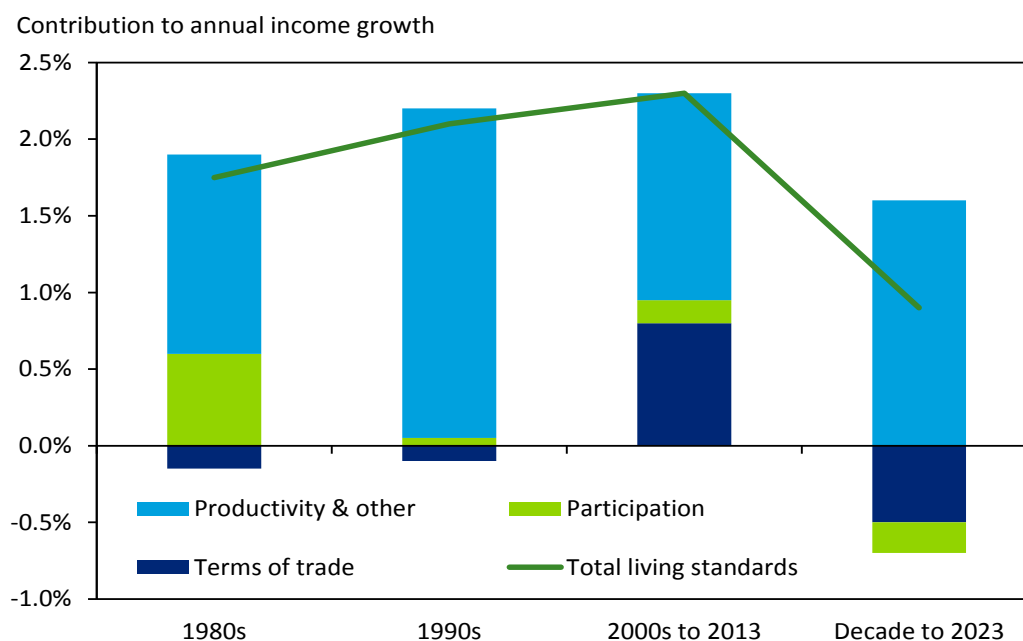
- the world gives us a pay rise, or
- a bigger share of our population works, or
- our workers become more productive.

A chart produced by David Gruen (then in Federal Treasury) lays that out. Demography – which shows up in the chart labelled as 'participation' – added to our living standards in the 1980s as women joined the workforce in considerable numbers, and was mildly positive thereafter.

However, a coming crescendo in the pace of baby boomer retirement means that it is expected to go the other way in the current decade.

That means that demography is changing from a tailwind into a headwind for Australian prosperity growth.

**Chart 1: Growth in real living standards per head**



Source: David Gruen, Federal Treasury; Deloitte Access Economics

And the same is true of what the world pays us. The 'terms of trade' hurt the national standard of living in the 1980s and 1990s, but not substantially so. And then the period from 2000 to 2013 proved to be a bonanza as the likes of coal and iron ore prices surged. However, here too the current decade is bringing some rather bad news as the global supply of commodities is finally catching up to the past decade of rapid demand growth.

Therefore much rides on a sharp improvement in productivity gains. The chart here assumes productivity gains in the next decade match the average of the last thirty years. That of itself would be an improvement on the past decade. Yet it would see growth in living standards fall to less than half of what we have been used to receiving.

That points to a national challenge. Although technological trends can help make our workers more productive, chances are that Australians will see little growth in living standards until we see much needed economic reforms.

## **Taxes have a big impact on prosperity**

The Federal budget is Australia's social compact. The two big aims of any society's social compact are prosperity (size of the pie) and fairness (how it is sliced).

Although some taxes have a major bearing on fairness (superannuation is a good example), as a generalisation taxes have a bigger bearing on prosperity. That is because some taxes (State stamp duties on business and residential conveyancing, insurance taxes and royalties, and Federal company taxes) hurt the economy more (have higher 'deadweight losses') than other taxes (such as the GST or broad-based land taxes).

Accordingly, tax reform is mostly a prosperity story – if we can shift from bad taxes to better ones, then we can make Australia and Australians more prosperous.

## **Spending has a bigger impact on fairness**

In contrast, and again as a generalisation, spending is a more effective lever around fairness. For example, were the base of the GST to be widened and / or its rate lifted, that would raise prices. To protect the less well off, the main lever to move in response would be to raise pensions and benefits.

## **All taxes distort economic activity in some way**

The worst taxes shrink the economy a lot for every dollar they raise – hurting the prosperity of families and businesses.

Given markets are usually best at allocating resources, the goal is to raise revenue in a way which least distorts market outcomes. As a generalisation:

- Higher taxes should be raised on less mobile bases (such as land rather than capital).
- Higher taxes can be less damaging where either the demand or supply side of the market to be unresponsive to tax – meaning that governments don't change choices.
- Business taxes are often less efficient than taxes on households as they distort capital decisions.
- Concessions can reduce the effectiveness of efficient taxes.

Success on that front – in shifting from 'more damaging' to 'less damaging' taxes – can therefore boost the efficiency of the Australian economy and thereby add to the prosperity of Australia and Australians.

## **Treasury estimates of the potential gains from reform have risen**

Just how damaging are particular types of taxes? That question is an important one, as it determines the potential 'size of the prize' in shifting to a more efficient tax system:

- If all taxes have similar 'marginal excess burdens', then there would be little to be gained from tax reform.

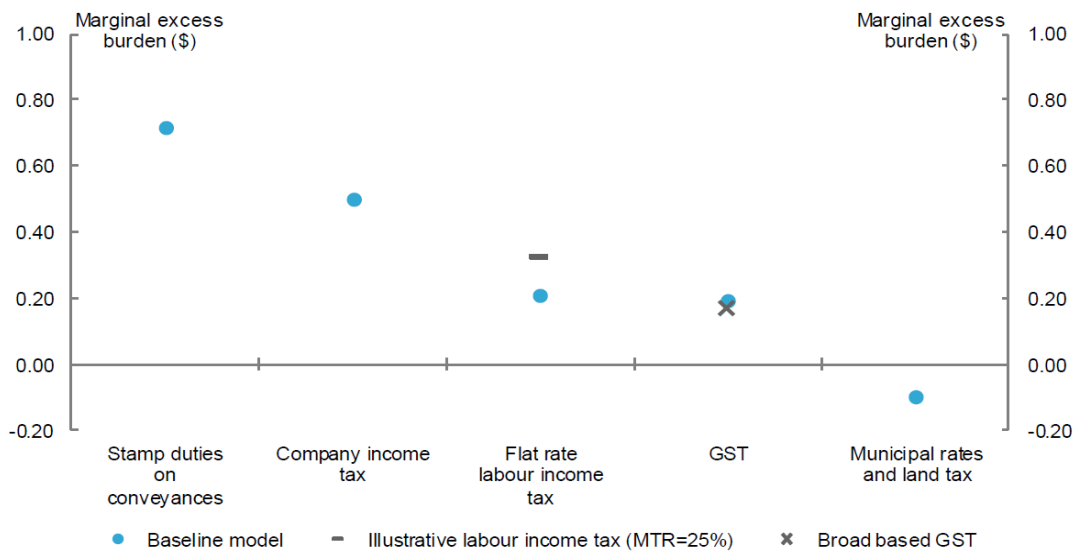
- But if some taxes are rather worse than others, then this nation has prosperity potential if it can realise those efficiencies.

The good news for Australia is that, although a boost to productivity is needed more now than ever to help maintain our prosperity growth, changes in estimates of the efficiency of Federal and State taxes imply that the potential return from reform has lifted.

- As a simple example of that, the estimates of the efficiency of various taxes has changed notably since 2010: work commissioned for the Henry Review<sup>1</sup> showed the marginal excess burdens of conveyancing stamp duties and municipal rates at 34% and 2%, respectively, whereas the 2015 Treasury Issues Paper (reproduced as Chart 2 below) seems to show matching estimates of 71% and negative 8%, respectively.

## Chart 2: Federal Treasury estimates of the efficiency of Federal and State taxes

**Chart 2.9 Long-run modelling estimates of the marginal excess burden of some of Australia's taxes**



Source: Federal Treasury

That changing view on relative efficiency has increased the gap between the ‘best’ and ‘worst’ taxes, and therefore it has increased the expected return to tax reform.

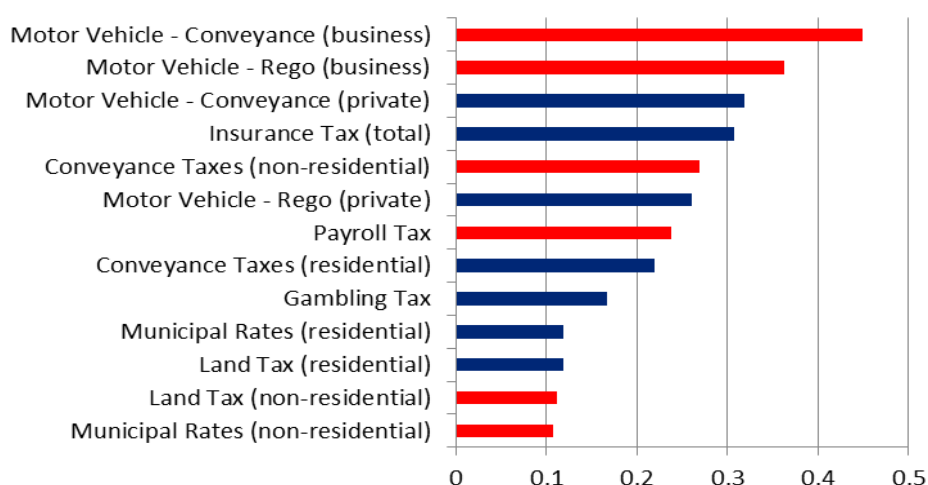
The resultant rising gap between ‘good’ and ‘bad’ taxes suggests that a substantive tax reform package could add some 2% to national income. If achieved, that would rank among the largest reforms ever implemented in Australia.

The matching estimates of tax efficiency from Deloitte Access Economics (seen in Chart 3 below) show less of a spread between the ‘best’ and ‘worst’ taxes, but are also consistent with the potential return from tax reform.

<sup>1</sup> (see Table 5.1 in [http://www.taxreview.treasury.gov.au/content/html/commissioned\\_work/downloads/KPMG\\_Econtech\\_Efficiency%20of%20Taxes\\_Final\\_Report.pdf](http://www.taxreview.treasury.gov.au/content/html/commissioned_work/downloads/KPMG_Econtech_Efficiency%20of%20Taxes_Final_Report.pdf))



**Chart 3: Deloitte Access Economics estimates of the efficiency of State taxes**



Source: Deloitte Access Economics

### The Budget backdrop is challenging

However, the Budget backdrop to the current reform process is challenging – meaning that not only is tax reform more needed and potentially more valuable than ever, but also that it will be particularly hard to smooth the way for much needed tax reforms by making them less than revenue neutral.

## 2 Tax reform process

We recognise the challenges that undertaking meaningful tax reform presents. We believe Australia can learn from the experience of countries such as New Zealand, where the Government successfully made the case for substantive tax reform of the New Zealand system.

In the case of New Zealand, the tax reform process resulted in a change in the tax mix from less efficient taxes (including reductions in personal income tax rates and potential bracket creep) towards more efficient taxes (including a rise in the rate of GST), with a resulting increase in potential prosperity.

The case for tax reform must be well communicated and must be clearly focused on the objective of increasing efficiency without compromising on the need for reform measures to be fair and equitable.

## 3 Corporate tax rate

The Australian corporate tax system is characterised by

- A high headline rate (by international standards), making Australia relatively less competitive on this score
- High rates of deadweight loss relative to other forms of taxation
- A large proportion of tax revenue collected by corporate tax (by international standards)
- A heavy reliance on a small pool of companies for a significant proportion of the corporate tax collections.

Any of these single factors could be the basis of an argument for change. Collectively, the argument for change is even stronger.

A reduction in the corporate tax rate needs to be considered, in conjunction with an analysis of the broader benefits that can flow to business and employees.

This review should be done in the context of other changes which affect the Australian tax mix.

## 4 Imputation

### Retaining dividend imputation

Deloitte is supportive of the retention of the imputation system.

However, we recognise that a national debate is underway. The decision to be made on how best to tax dividend income in Australia is a critical one, as the consequences are extensive across the corporate, capital markets and superannuation systems.

Most OECD countries have moved away from imputation in recent times, with only very few countries now operating a full dividend imputation system. A number of other countries provide relief from the taxation of dividends at the shareholder level by exempting dividend income partially or completely from shareholders' taxable income, or taxing dividend income at a preferential rate. However, there is no clear trend or indicators of which alternative system for the taxation of dividends would better suit Australia.

### An alternative system?

In principle, any alternative system for the taxation of company profits would need to score better than the imputation system on the following measures:

- Encouraging investment by Australian companies in domestic and global markets
- Attracting non-resident and resident investors alike
- Providing an even playing field for different types of investors (individuals, superannuation funds, mutuals etc.)
- Minimising distortions between corporate and non-corporate forms of conducting business
- Minimising distortions between debt and equity.

Deloitte's support for the retention of the existing system arises in part from the difficulty of achieving well against the above yardsticks.

If there were to be a change, there must be a fair and effective transition away from the current imputation system, while maintaining the simplicity and the integrity of the taxation system.

### Reforming dividend imputation

Where the imputation system is retained, consideration should be given to changes to some aspects of how it operates. For example, the refundability of imputation credits should be addressed. This was introduced for some taxpayers many years after the imputation system commenced. A key policy decision thus is whether the corporate tax and imputation systems should operate (for resident taxpayers):

- as an instalment-only type system so that corporate profits are ultimately taxed at the dividend recipient's marginal tax rate (whether higher or lower than the corporate tax rate), which is effectively the case now; or

- as a minimum level of tax on corporate profits, which was the case when imputation was first introduced.

## 5 GST

The current GST base is narrow, compared to its potential, taxing less than 60% of consumption.

Removing the current exemption for food should be considered.

It is less clear whether imposing GST on health and education would be appropriate. The additional cost would likely lead to some households moving out of the private education and health systems and relying instead on government-provided alternatives. This shift in demand towards the public sector could erode the anticipated increase in GST revenue and involve additional demand for government-provided services.

The latter would arise because the extension of the GST net to these fields would tilt the playing field away from competitive neutrality between public and private providers.

Changes (if any) to the GST rate, base and administration should aim to achieve the following goals:

- Improve the efficiency of the GST tax base,
- Provide a larger and more sustainable source of GST revenue, and
- Reduce complexity and compliance costs.

A single rate of GST, applied to the broadest range of goods and services, with minimal exemptions, would contribute substantially to achieving these goals.

Changes to the rate, and/or base, of the GST would need to be accompanied by an adequate and appropriately structured compensation package for lower income households. Fair compensation could not be achieved through income tax cuts alone. Those on the lowest incomes, including pensioners and the unemployed, who pay little or no income tax, would need to be compensated via increases in relevant Government payments. Such compensation could provide better targeted assistance than the current GST exemptions.

Any tax reform discussion should also provide an opportunity to simplify the GST law, and to revisit unimplemented measures from previous tax reviews such as:

- Making greater use of GST-free treatment or reverse charging of B2B transactions
- Development of an alternative method of taxing domestic consumption of financial services.

A lowering of the \$1,000 'low value' exemption threshold for imported goods continues to be problematic, due to the costs of collection and enforcement. That said, consideration should be given to lowering the threshold in conjunction with amending the GST law to require foreign suppliers to register for GST and remit GST on goods supplied to Australian customers. Any net revenue increases on offer here are likely to be relatively small, however there should be additional benefits in terms of improvements in competitive neutrality and the integrity of the GST system, and should be addressed.

# 6 Superannuation

## Introduction

When Australia first considered the shift to compulsory superannuation, most actuarial estimates of the required contribution rates to achieve adequate retirement incomes centred on a 15% contribution rate. The resources boom of the past decade saw that equation change – personal income tax rates were lowered, the tax on superannuation end benefits was abolished, retirement ages lifted, benefits to self-funded retirees were increased, the age pension was formally indexed to wages rather than prices, and the taper rate for means testing of pension entitlements was made more generous.

Most importantly, however, a long boom in markets here and overseas saw a marked leap in household assets held both within and outside the superannuation sector.

Hence estimates of retirement income adequacy leapt during the resources boom.

Despite the fact that Australia's superannuation system is still well shy of maturity (when all workers will have paid compulsory superannuation across their entire working lives), retirement income adequacy rose rapidly through to 2007, aided by strong markets and by the legislative and regulatory changes accompanying the introduction of the *Simpler Super* system. However, the global financial crisis hit sharemarkets, and a combination of reduced asset price inflation and cuts to contribution caps have hit voluntary contribution rates. That has seen measures of retirement income adequacy subsequently steady. Increasing longevity has also meant that the amount needed to provide an adequate income in retirement, as measured by the Association of Superannuation Funds of Australia (ASFA) Retirement Standard, has increased dramatically and will continue to do so as future generations experience greater longevity as estimated in the 2015 *Intergenerational Report*.

## Objectives of a superannuation system

As with all tax reform policy proposals, there are key performance criteria to consider:

- Efficiency – Does the policy achieve those goals at the lowest economic cost?
- Equity – Are the benefits of the policy fairly spread across the community?
- Complexity – Does the policy impose extra compliance costs on the system?

Australia's retirement income policy is currently designed around three key policies known as the 'three pillars'. They are:

- Providing a safety net through the Commonwealth aged pension
- Increasing private provision for retirement through the compulsory 9.5% contribution
- Encouraging voluntary contributions to super by offering tax concessions and co-contributions to those who choose to save more for their retirement, as well as private savings occurring outside the superannuation system.

We agree with the *Financial System Inquiry Final Report November 2014* that there needs to be a purpose statement for superannuation on which all policy will be based<sup>2</sup>. Establishing a purpose statement for superannuation is important as it provides a basis for designing the policies – including tax policies – to support a robust, efficient and equitable superannuation tax system.

---

<sup>2</sup> "Set a clear objective for the superannuation system to provide income in retirement" <http://fsi.gov.au/publications/final-report/executive-summary/>

Government policy should be focused on ensuring that the superannuation system achieves the purpose of:

- supporting retirement incomes; and
- reducing the future reliance on the aged pension.

Given these key aims, the resultant indirect benefits of the superannuation system may be to:

- provide long-term funding for economic activity in Australia both directly and indirectly through funding financial institutions; and
- contribute to the stability of the financial system and the economy.

However, the primary focus of the reforms to the superannuation tax system should be in relation to individual members' interests – supporting people to save for their retirement over their lifetime. That role for the superannuation system is consistent with other areas of the tax system that provide tax discounts to those who save so as help limit the 'double taxation of savings'. Taxation affects savings in two ways:

1. It cuts the amount of income they are able to save and thus indirectly reduces the interest they receive on their savings.
2. And it directly taxes the interest income they do receive.

In contrast, those who don't save are only taxed once.

That means there is a case to tax savings at preferential rates – and, as discussed separately with respect to the CGT discount, to do so as consistently as possible across different types of savings, including savings through the superannuation system.

## **EET or TEE?**

Taxation of the superannuation system can occur at the contribution, accumulation, and / or withdrawals stage. The economics literature recommends adopting either an income tax base with preferential treatment of savings (in which case most of the tax occurs at the contributions stage) or an expenditure tax base (in which case most of the tax occurs at the withdrawals stage).

These two models are known, respectively, as TEE (taxing contributions, and exempting earnings and withdrawals from tax) or EET (exempting contributions and earnings from tax, and taxing withdrawals) systems.

Prior to 1983, Australia had an essentially EET system, but over time it has shifted closer to a TEE system.

## **Taxation of contributions and contribution caps**

Deloitte would support a superannuation system that taxes contributions at marginal rates with a sliding savings discount. The need for contribution caps should not be relevant (or be much less relevant) if contributions are taxed at discounted rates linked to marginal taxation rates and earnings are taxed in accordance with our suggestions below. Ideally, the concession would simply compensate for preservation arrangements and the over-taxation of savings. A superannuation system that taxes contributions at marginal rates, with a sliding savings

discount, and a concessional rate on earnings could result in a lower level of tax on earnings and tax-free income streams on retirement. Current superannuation members near retirement should not be affected (since income and contributions have been built up over many years under existing rules). From a

revenue perspective, taxing upfront contributions rather than retirement streams means there is no delay in the Government receiving the taxation stream.

In reality, some caps on concessional contributions would be needed for the years immediately prior to retirement (as these would have lower costs to the individual in relation to preservation and the over-taxation of savings).

It will be important to consider the impact of how earnings and benefits are taxed. Non-concessional caps would also be needed to avoid very large accumulations within a tax preferred vehicle. We would suggest that these caps be more flexible than existing caps which do not reflect on an individual's ability to save during different phases of a working life and discriminate against many women who have periods out of the workforce to have and raise children. We recommend that a lifetime cap approach, both for concessional and non-concessional contributions be adopted. These contribution cap limits should continue to be available past the pension age provided the individual continues to earn income. If the caps have been reached, then employers should be exempt from any further SG arrangements and the individual would not be allowed to make any further contributions.

## Earnings rate

Our view is that the taxation regime applying to superannuation earnings should be the same across accumulation and retirement phases. A reduced earnings tax rate in both the accumulation phase and the pension phase has been mooted previously, would be preferable in terms of administrative simplicity, and is consistent with moving the Australian system closer to a TEE basis.<sup>3</sup>

Deloitte would support a review of the continued appropriateness of the capital gains tax (CGT) discount of 33% in superannuation funds. In principle, the CGT discount should be the same for similar assets in or out of superannuation unless there are public policy reasons for deviating from this position.

## Taxation of benefits

On the basis that the aim of Government intervention should be focused on ensuring that the superannuation system achieves the purpose of supporting people to save for their retirement over their lifetime, consideration needs to be given to whether our superannuation system should include requirements/restrictions on the drawdown of benefits in retirement. A key risk within the superannuation system revolves around the fact that future generations will experience greater longevity. The Murray Review notes that *"The taxation and social security systems could be used to create strong incentives for retirees to take superannuation benefits as income streams that help manage longevity risk"*.<sup>4</sup>

An effective tax system needs to address this risk. We would suggest that consideration be given to the merits of introducing a form of compulsory drawdown of account balances in retirement or a compulsory income stream requirement which limits the proportion of benefits being taken only as a lump sum.

## Preservation and adequacy

In turn, preservation of member benefits is an important and fundamental aspect of our superannuation system and should remain (to the exclusion of proposals for drawdowns for first-home purposes and education).

We do however note that other jurisdictions do allow for such drawdowns. For example, Canada has a home buyer's plan that allows people to withdraw up to \$25,000 in a calendar year from their retirement

---

<sup>3</sup> [Australia's Future Tax System \(Henry Review\) Part 1](#), p. xxii

<sup>4</sup> <http://fsi.gov.au/publications/interim-report/08-retirement-income/policy-options-for-consultation/>

savings in order to “buy or build a qualifying home for you or for a related person with a disability”<sup>5</sup>. In addition, Singapore allows part of super contributions to be used to buy property as well as cover education costs<sup>6</sup>, yet the contribution rate is significantly higher than in Australia. However, there is not clear evidence that these programs have been a success, and they come at the cost of having Australia’s retirement incomes system trying to achieve more than one aim (not merely retirement income adequacy, but also home ownership).

An additional method of addressing adequacy is to look at superannuation balances within a family unit and not necessarily as only individual balances. Deloitte would support looking at whether any contribution caps should be combined as a ‘spouse cap’, in order to address circumstances where, for example, a member of the family has transitioned in and out of the workforce to be a primary carer to children.

We do not support a restriction on the age at which you should be able to contribute to superannuation, provided those contributions are made prior to drawing down benefits in retirement. Individuals should be able to contribute to superannuation throughout their lives to accommodate for a population that is living longer and moves in and out of the workforce several times due to changes in personal circumstances.

Any increase in the preservation age could place financial hardship on those in physically demanding jobs (such as construction, mining, and agriculture), so reforms or opportunities in the labour market need to go hand in hand with superannuation policy.

That said, there needs to be close links between preservation age and the age for eligibility to the age pension. As the latter is rising in response to increased longevity, Deloitte recognises the need for a reconsideration of the preservation age as well.

## **Certainty and confidence**

One of the key issues with engagement with members is the fact that individuals are concerned about the system continually changing and therefore lack confidence in it or do not understand it.

Deloitte would welcome changes to the superannuation system that ensure it better meets its aims for a given cost to taxpayers. However, we encourage the Government to consult and road test all possibilities.

Should changes be necessary to the tax settings for superannuation, a defined review period has merit.

If there are to be significant changes to the superannuation tax system, our preference is to avoid significant grandfathering provisions. That said, those approaching retirement should not be adversely affected by changes provided any grandfathering is equitable and does not impose a significant administrative burden on the rest of the superannuation system.

---

<sup>5</sup> <http://www.cra-arc.gc.ca/tx/ndvdl/tpcs/rrsp-reer/hbp-rap/menu-eng.html>

<sup>6</sup> <http://mycpf.cpf.gov.sg/Members/CPFSchemes/CPFSchemes.htm#a2>



## 7 Tax Treatment of outbound and inbound investment

### Anti-deferral (CFC) rules

There has been a significant increase in the number of Australian businesses operating in global markets since the introduction of the CFC rules. In addition, Australia now has comprehensive transfer pricing and anti-avoidance measures which in many cases overlap with the anti-tax deferral rules. While Deloitte supports the continued use of anti-tax deferral rules, the scope of their application should be reconsidered and the reform of the anti-tax-deferral rules should be revisited.

The case for adopting many of these recommendations remains strong and these reforms will help ensure Australian entities operating in foreign jurisdictions remain competitive with their global peers. In particular, we should revisit the following matters:

- The divide between active and passive income;
- Narrowing the broad scope of tainted sales income and tainted services income; and
- Considering the previously proposed exclusion of lightly taxed entities such as superannuation funds.

We suggest this should occur after the OECD completes its work on CFC rules as part of the BEPS project.

### Interest expense

Given existing strong thin capitalisation rules, transfer pricing rules and anti-avoidance measures, Australia already has strong and effective measures to restrict excessive interest deductions. As a capital importing country we need to be vigilant that any measures arising from BEPS Action 4 (interest deductions) together with our existing laws and relatively high corporate tax rate do not result in a regime that is contrary to the national interest.

### Sovereign Immunity

Australia is a net importer of investment capital – and such capital is highly mobile. As such, it is important that our tax system facilitates continued foreign investment by sovereign wealth funds, which are often seeking long-term investments in areas such as infrastructure assets.

The Australian tax law should provide specific guidelines as to the availability of the principle of sovereign immunity, consistent with the trend in Australia's bilateral tax treaties, to ensure we continue to provide an attractive and efficient location for such foreign investment capital.

## 8 The tax treatment of risk taking: Losses

The same business test by its very nature is somewhat counter-intuitive. Where a business incurs losses in one year, the existing test may discourage this business and investors from making changes to its business, yet at the same time, a return to profitability necessarily requires change.



The tax treatment of losses should not impede businesses from adapting to changes in commercial and economic circumstances. Managing revenue concerns together with tax integrity concerns should be weighed against the prospect of stifling healthy corporate risk taking behaviour.

The preferred model of the the Business Tax Working Group for improving the existing loss integrity rules was a combination of modifying the existing SBT so that it better aligns with the modern business environment; and introducing an alternative statutory drip-feed mechanism calculated on a straight line basis.

Deloitte supports a review of the existing loss integrity measures in line with the recommendations referred to above.

## 9 Revenue versus capital

At the heart of the Australian income tax system is the distinction between revenue and capital. There is a long history of litigation and uncertainty associated with this core question.

Consideration should be given as to the introduction of a “bright line” test for determining whether an amount is on capital or revenue account for tax purposes. For example, the United States provides for a reduced rate of tax for individuals in respect of gains which relate to assets held for more than one year. Australia should consider the benefits of adopting a more simplified approach to eliminate the facts and circumstances revenue/capital distinction.

## 10 Innovation

### Existing R&D regime

The following should be considered in a review of the existing R&D regime:

- Whether the awarding of direct grants would better achieve the objective of incentivising innovation
- Whether the definition of eligible R&D entities should be widened to increase R&D in small unincorporated businesses
- Whether the refundable R&D tax incentive should be available to a wider range of companies
- Whether the quarterly refundable system proposal should be reinvigorated, as proposed by the Murray Inquiry into the Financial System
- Whether costing compliance simplifications could streamline the administration of the incentive, and
- Whether non-technological or business model R&D should be incentivised.

### Other incentives

The current R&D tax incentive regime encourages domestic, and internationally mobile capital onshore, to undertake R&D. However, there is a gap in the subsequent taxation or regulatory incentives that would make it easier to fund the subsequent manufacture of the new products or the infrastructure in Australia.

That is, once the research phase has been completed, how do we better retain the subsequent manufacturing and commercialisation phases in Australia? To date there have therefore been pressures on

local businesses to replicate the required skills offshore in low cost countries with better incentives, especially where the R&D has resulted in portable knowledge-based IP.

Subject to appropriate cost / benefit tests, consideration should be given to a robust patent box regime offering a reduced rate of taxation on the income or profits generated by Australian-based R&D.

The OECD has recently considered these issues in detail as part of the BEPS project and the recommendations made by the OECD provide a useful starting point for discussion on this issue, and development of a non-harmful tax regime.

It is important for Australian public policy settings to be innovative themselves, and to maintain pace with our global competitors. Further details will be provided in a separate Deloitte submission on Innovation.

## **11 CGT discount and negative gearing**

### **CGT discount – rate**

The Bill introducing the CGT reforms (including the CGT discount) stated that the objective of this measure was to “aim to encourage greater investment by Australians and to improve the international competitiveness of Australian business.” The measures effectively replaced the previous indexation system.

The extent of the CGT discount (especially in a low inflation environment) is larger than the concessions which may apply to income earned from savings or other investments.

The rate of the CGT discount should be reviewed.

### **CGT discount – scope**

Further, the policy rationale to support having a different treatment of income and gains from different types of investments should be considered.

In order to encourage savings and investment and to avoid the tax system distorting saving and investment decisions, there should be a consistent approach to the treatment of investment income and gains. For example consideration could be given to adopting a single ‘system-wide’ discount rate, which would apply to income and gains from all types of investment.

Alternatively, tax concessions could be introduced for savings income.

Any changes to the current system may need to be introduced in a phased approach, for example, a reducing CGT discount over a period of years to minimise the disruptive effects of any changes.

### **Negative gearing**

In principle, a deduction for interest should be available irrespective of the type of income-earning investment and should be treated like any other tax deductible expense. To limit deductions solely in respect of housing investment would be to introduce another distortionary element into the tax system. At present we believe the CGT discount regime, when combined with the use of negative gearing, is the key factor distorting investment decision-making in the area of housing investment, rather than the availability of negative gearing.

Against that backdrop, Deloitte supports a review of the CGT discount and the continuing application of negative gearing,

## 12 Fringe Benefits Tax

### Fringe benefits tax versus taxed to employees

Consideration should be given to whether the legal incidence of taxation should be moved to employees (a recommendation made by the Henry Review in respect of benefits “that are readily valued and attributable to individual employees”), and whether there would be a reduction in complexity and compliance costs.

### Reforming the fringe benefits tax system

The complexity of complying with FBT obligations is a key concern for most businesses. A priority should be to address the complexity of the FBT system, in particular reducing the compliance costs for employers.

If the FBT system is to be retained, consideration should be given to:

- the use of safe harbours
- simplification of valuing benefits (eg. car parking);
- decreasing compliance costs associated with exemptions, concessions and the valuation of benefits; and
- ensuring that the FBT system does not become a de facto channel for reducing tax liabilities below where they would otherwise be.

This may involve both legislative changes as well as administrative relief by the ATO.

## 13 Tax settings for Not-for-profits

The NFP sector needs a financial assistance framework that supports it effectively. It should be acknowledged that the NFP sector is currently experiencing significant disruption as it adapts to challenges such as the ageing population, changing trends around disadvantage, changing fund-raising and donation patterns and considers new ways to deliver services to its clients.

The rationale for providing tax concessions to the NFP sector continues to be valid, that is: without incentives, the overall level of activity in the NFP sector may be below what is optimal in society. However, it is less clear that those incentives are best delivered through the tax system, and the tax reform process should consider possibilities around ‘cashing out’ current incentives and replacing them with direct subsidies.

Any reform of the taxation arrangements for the sector should consider the following:

- Maintain the existing funding levels (but potentially through spending rather than via tax incentives)
- Be sufficiently certain (that is, to the extent that tax concessions are replaced by a discretionary grant system, the latter needs to be locked into five year rolling plans to ensure that the NFP sector has visibility on its funding)
- From an equity perspective, some FBT and income tax concessions should be reviewed with a view to considering whether they have achieved their policy objective

- From a regulatory and red tape reduction perspective, the existing tax concessions are complicated and difficult to administer. The concessions should be streamlined to apply as much as possible across all types of NFP entities. For example:
  - Donations to all registered charities should be tax deductible. The difference between DGR status and charitable status is confusing
  - The process for applying for DGR status could be streamlined.

## 14 State government taxes

A review of State tax arrangements should aim to achieve the following goals:

- Improved revenue raising capacity of each State – as part of an overall approach aimed at ensuring that the States have adequate funds to finance the services and functions for which they are responsible
- Greater efficiency of revenue sources. For example, increased reliance on immobile bases (i.e. broadly applied land-based taxes such as land tax and municipal rates)
- Improved consistency across the States. The efficiency of payroll tax has been weakened by tax competition between the States, which results in increases in the tax free thresholds, variable rates and special exemptions. This could be addressed by greater harmonisation of threshold and exemption arrangements across States, reducing payroll tax complexity
- Appropriate phasing-in arrangements to minimise any adverse or unanticipated impacts for particular groups such as low-income home owners
- Harmonising the treatment of contractors across payroll tax, FBT, Superannuation Guarantee, and WorkCover, and
- Taxes that were previously earmarked for abolition (typically viewed as undesirable on efficiency and equity grounds and which impede economic activity) should be abolished.

From a red tape reduction perspective, the existing land tax and conveyance duty rates, concessions and exemptions are complicated and difficult to administer. At a minimum, the tax settings for these tax imposts should be standardised across States, particularly as there is no real competitive tension between states given the immobility of land.

## 15 Personal tax returns

The Henry Review and the ATO have both considered at various times reforms to the personal income tax return compliance process including prefilled returns, standard deductions and other changes to eliminate cost and complexity associated with lodging personal tax returns.

We consider that such reforms should be progressed, for simple case personal tax returns, with an opt-out choice for taxpayers who wish to complete tax returns in the current manner.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/au/about](http://www.deloitte.com/au/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Liability limited by a scheme approved under Professional Standards Legislation.