**INTRODUCTION**

Below are ideas that, if implemented, would simplify the Australian system of taxation and, by doing so, reduce the cost of administration for participants (including the ATO). The ideas have not been subjected to detailed analysis necessary to quantify savings that might accrue – as the writer does not have access to the data needed to do this.

**COMPANY TAX**

Company tax in Australia is probably the least efficient and effective of all taxes. It is often compared with company tax rates in other countries as a measure of the cost of doing business for investors in Australia; and, at 30% is, too often viewed as unfavourable in this context.

Yet company tax delivers very little real income to the government. The system of imputation credit in Australia, rebates company tax paid to shareholders when dividends are paid. Where all shareholders are also Australian taxpayers, and have other taxable income, all of the company tax paid by the company is rebated to the shareholders in their personal tax as imputation credits.

Obviously the government has the benefit of being able to use the company tax paid until the year in which dividends are paid but, if eventually, all the company tax is rebated to shareholders in the tax year in which the dividends are declared, then the only real value of company tax to government is the time value of the money until it is rebated.

Equally obviously, the only company tax retained by government is from shareholders who do not pay tax in Australia or Australian investors who do not have sufficient other income to use the rebate. This, it is suggested is a small amount – perhaps one or two percentage points of company profit, or 0.1 or 0.2 percent of company income.

As such it could easily be replaced by a small increase in GST or introduction of a new ‘business’ tax – a charge levied by government for the company’s use of the taxpayer funded business infrastructure, calculated as a percentage of dividends paid by the company, and levied at the time those dividends are paid.

There would be no further requirement for companies in Australia to submit company tax returns. And the imputation credit system would be obsoleted. The only administration required for the ‘business tax’ would be for details of all dividends paid to be provided to ATO at the time of payment. Existing processes already provide the ATO with this data for listed companies and could easily be expanded to include payment of private company dividends.

Doing away with company tax, even if a new ‘business’ tax has to be introduced, could be done with minimum implementation cost, minimum ongoing cost, and no loss of current revenue.

The benefit to Australia comes from the administrative savings to ATO and companies involved – but, significantly, from having Australia seen as one, if not the only, developed country where there is no tax on doing business.

In terms of fairness, the proposal also addresses two areas in current taxation of companies that are unfair to some taxpayers. Overseas shareholders who happen to have organized their affairs so that, despite receiving income from Australia, they do not pay taxes in Australia, would, under this proposal, pay a share of tax through the business tax. And low income shareholders who are unable to use the available imputation credit rebates would no longer suffer this disadvantage compared to wealthier shareholders.

**DOING BUSINESS IN AUSTRALIA**

An Australian resident doing business in Australia does so either as a ‘sole-trader’ or through a company structure. What is hoped is just a relatively small number do business through the ‘black’ economy - evading government scrutiny and regulatory obligations.

For many businesses, what initially may seem to be the least cost/least fuss option of the ‘sole-trader’ is quickly overtaken by regulatory obligations (such as GST, PAYGW, FBT, Super Stream, etc) and is, more often than not, converted to a company structure.

Further complicating the issue of doing business in Australia is the fact that the ‘black’ economy has recently received indirect support and sanction from the government by the exclusion of imported goods costing less than $1000 from import duties and GST.

In effect, overseas companies can sell their products into Australia without regard to tax and other statutory obligations. This is clearly unfair to Australian businesses, and, in fact, adds an incentive for Australian companies to join the ‘black’ market by factoring products through off-shore companies.

But it also undermines one of the main design points of our tax system – that entities making money in Australia pay taxes in Australia.

The complexities of our two structure system, and the government sanction of tax avoidance by overseas entities, could be simply removed by:-

1. Defining ‘doing business in Australia’ as selling goods or services to any person while that person is physically in Australia and where the contract of sale (or implied contract of sale) requires delivery of performance in Australia.
2. Requiring that all entities wishing to do business in Australia register for an ABN
3. Requiring that all ABN registered entities display their ABN on sales invoices and all marketing material (including web sites) used to promote sales in Australia.
4. Letting it be known that entities found doing business in Australia without an ABN will suffer significant financial penalties.
5. Letting it be known that consumers may be rewarded for helping identify entities doing business in Australia without an ABN.

While threats of penalties may not deter overseas entities from attempting to sell their products into Australia via the Internet, government sanctioned ‘denial of service’ to the Internet in Australia for such offenders, would.

Admittedly, to take this approach will require small businesses who have not already done so, to pay for setting up a company structure – less than $500 if they do it themselves on The Australian Business Register website. But this is a cost that, to most, is inevitable anyway. No doubt ATO could offer some appropriate incentives to have them take the step sooner rather than later.

And whether they know it now or not, separating out their business affairs from personal affairs for most existing ‘sole-traders’ will, in fact, reduce their accounting fees in the longer term.

Implementation of this proposal would massively simplify tax rules and regulations around doing business in Australia while providing a simple set of rules for people considering doing business in Australia from overseas.

**GST**

The design of the GST system in Australia has been borrowed from similar ‘Value Added Tax’ systems overseas. Hence, while charging a ‘consumption’ tax on the end user of a product or service, it attempts to distribute the profit inherent in the product between all the participants of the value chain in proportion to the value-add by each participant. The assumption here is that company tax is a function of profit - so not to distribute GST in this way would be inequitable.

But if this was the objective, the implementation fails totally. In Australia GST is a balance sheet item and causes no change to company tax obligations of value-chain participants.

So, forcing all players in the value-chain to track and report GST at the transaction level serves no practical purpose in Australia except the early receipt of tax at the ATO. But it does impose considerable administrative cost on all businesses and requires significant investment by ATO in people and technology to oversee it.

The system could be simplified greatly by just requiring that only an entity that sell GST designated products to a customer in Australia invoices and collects the GST – but only from customers who are unable to claim GST exemption by showing a valid ABN.

The selling company would continue to be required to validate the customer’s ABN (using existing capability) before it could grant an exemption. But, for such companies, whose primary role is as participant in the value-chain, such tracking is already part of their existing processes.

Changing the GST in this way would dramatically reduce administrative compliance costs on all participants of the value-chain except the one selling product to the non-exempt end-user. The change could be easily and quickly implemented.

**PERSONAL INCOME TAX**

The ATO has recently announced that it will soon be able to accept online submissions of annual tax returns from private taxpayers – replacing the current eTax system.

Users of eTax will know that, increasingly, the great bulk of transactions effecting their personal tax are already being captured from inputs received from employers (for salary data), Companies (for dividend and imputation data) and other government departments (for pension and welfare payments and entitlements).

We are fast approaching the point where the ATO will be able to present online a prefilled tax return that the majority of taxpayers could simply accept by doing nothing, or could use to open a discussion with ATO if he or she wished to submit changes or additions to prefilled data before the return is finalized.

The ATO is to be complimented on its progress thus far – but clearly needs to be more aggressive in letting people know where the current initiatives are headed – so that individual tax payers can organize their personal affairs to best utilize the effectiveness of the default return prepared by the ATO.

**BUDGET CONTROL**

The budget position that Australia finds itself in at present dramatically illustrates that the processes for federal financial management are flawed. The tax system is totally divorced from budgetary process.

In our democratic process, failure to meet budgetary objectives might eventually lose an incumbent votes. But not before years of deficits can be accumulated. As anyone who has been involved in private sector business operations knows, any business that took years to correct budgetary imbalances would soon be out of business. It is suggested that budget management in government needs an approach more like that of private enterprise.

The budget process and the tax system should be connected by statutory, if not constitutional, regulatory change. The regulations should require that any operational (not capital) budget imbalance, at year end, be corrected within twelve months by automatic change (up or down as appropriate) to the GST.

To dampen the effects of such change on the economy in general, and on the disposable income of taxpayers in particular, any change in GST should, automatically, be offset with a matching change in the percentage of employee salary which must be submitted via Super Stream to the employee’s superannuation fund.

Such a change would make the GST the scorecard on the operational effectiveness of government. The government of the day would be required to share with the people, through the budgetary process, the external or internal factors that have created the need to change the GST and the SGC and what will be done in the current budget to correct the problems.

Importantly, it would no longer be possible for today’s taxpayers to live beyond their means by passing their debts on to future generations. If they were to allow their politicians to accumulate debt, they would be paying for that debt themselves by reductions in their own retirement nest egg.

By the same token, good government would be rewarded with Lower GST, and a higher standard of living in retirement for the people who made it happen.

Adoption of the proposal would act as an incentive for people to be part of the solution rather than part of the problem.

**TAX ON SUPERANNUATION**

The idea behind the ‘super’ system in Australia is that, while we are working, we should put aside sufficient funds to support us, at least in a basic way, when we retire.

Sounds good – even noble. But it really was not thought through very well. The world consists of two classes of savers – those that do and those that don’t. Those that do will save for retirement whatever Canberra does. Those that don’t may save when forced to do so but will look to cash out as soon as they can.

We have a system designed for the average Australian, who does not, in reality, exist; and which is being used in ways that were never intended. There really are people who, when they retire take the lump sum, pay off the mortgage on the family home or take the big overseas trip, and front up to Centrelink the next day to get the age pension.

And there really are people who have more cash in their super fund than they can possible need in retirement. Where else can you invest with a zero tax on earnings and with the only limitation that you must take a small minimum of the account balance as pension each year?

Both of these practices are wide spread and dramatically opposed to the intent of the superannuation system. They can be easily stopped by simply giving notice that:-

1. With effect from (say) 1 Jul 2017, the maximum that can be taken under the current pension tax exemption will be twice the published minimum pension percentage.
2. Pension account withdrawals in excess of the published maximum will be taxed at the taxpayer’s marginal tax rate.

It is anticipated that such an announcement would cause a significant redeployment of value from existing super funds to other forms of investment. That could only be good for today’s sluggish economy.

**IMPUTATION CREDIT SYSTEM**

When the dividend imputation system was introduced in Australia by the Hawke/Keating government it was a serious ideological, legal, operational, and economic, mistake.

It provided a significant advantage to those rich enough to be able to afford shares – further disadvantaging the low income earners who could not. It undermined the legal separation of shareholders from the decisions of directors running companies. It increased significantly both the administration of personal taxation and that of company taxation. Importantly, it also significantly reduced the tax ‘take’ of government.

It was sold to taxpayers (or perhaps to voters) as a reform correcting the unfairness of ‘double taxation’. It appealed to the ‘left’ as taxes were to be levied on shareholders on the before-tax profit instead of just the after-tax profit.

But this thinking was fundamentally flawed. Look at the numbers. Before the change, the ATO received (say) 30% of each $100 before-tax profit as company tax. The after-tax profit of $70 was distributed as dividends and shareholders were taxed at (say) 35% marginal tax rate on the $70 dividends. The ATO received a total of $54.50 of each $100 of before-tax profit.

After the change, the company paid the same $30 in tax but the shareholder was taxed at (say) 35% of the pre-tax profits of $100 – that is $35. But the shareholder was granted a rebate of the $30 tax paid by the company. So the shareholder now only paid $5. The total received by the government was $35 ($30 from the company and $5 from the shareholder). Ignoring the fact that the rebate is not paid to overseas shareholders who have organized their tax affairs to evade tax in Australia, the Government forfeited almost 20% of tax on pre-tax profits with this change.

Treating company tax as just a prepayment of shareholder dividends was seriously flawed thinking. By law, the shareholders of a company and the company entity are separate legal entities. Company law provides well understood and necessary legal separation of the shareholders from the decisions made by directors of the company. Considering company tax as a prepayment of dividends seriously undermined that basic assumption. It should never have been allowed.

It is suggested here that all taxpayers should be treated as indirect shareholders in every company that does business in Australia. Whatever taxes are levied at the company level should be viewed as payment of dividend to the government on behalf of those shareholders for the company’s use of business infrastructure (both legal and logistical) provided by taxpayers. Without access to this infrastructure the company could not operate - let alone make profit.

Whether company tax is considered a charge the company pays for access to the market and use of the infrastructure, or a dividend paid to all taxpayers who are indirect shareholders of the company is debateable. But what is not debatable is the fact that rebating company tax to only the direct shareholders was morally wrong and should never have been done.

It is proposed here that the imputation credit system be immediately abolished (as it has been in most other countries) and the current company tax be replaced with a business tax of (say) 20% - payable to ATO at the same time as dividends are declared and paid to direct shareholders.

This would provide immediate relief to the budget. Instead of the $35 tax on every $100 of net-before tax profit made by companies, the government tax take would increase to $48 ($20 at the company level and 35% of $80, or $28, from shareholders). The government tax take from these sources would increase from $35 today to $48 – an increase of 37%.

Were this proposal to be implemented:-

1. Australia could boast a company tax rate of 20% - amongst the leaders in the developed world and a real incentive for investment.
2. If the 20% is levied as a dividend to indirect shareholders at the same time as dividends are paid to direct shareholders, there would be no reason for companies to lodge annual tax returns. All that would be required would be a payment to ATO whenever dividends are declared and paid to direct shareholders. This would dramatically simplify company tax administration and reduce costs for the ATO.
3. Personal tax administration would also be simplified – with dividends ‘pre-filled’ by ATO into personal tax returns and without any effort needed by taxpayers to identify franking percentages and the like.
4. The government tax take from these sources would increase by about 37% as detailed above. This would go a long way to helping ‘balance’ the budget.

The existing direct shareholders would of course, at least initially, be disadvantaged. They would lose the benefit of the rebate against tax payable by them. Given that these taxpayers have, for well over a decade, received rebates to which, it may be argued, they were not really entitled, they may accept the change without too much negative reaction.

It may well be, however, that business-savvy shareholders will see the significant advantage to a company in not having to pay taxes until it is also able to pay dividends. They may well also see that profits (and dividends) are likely to increase in this environment.

Abolishing the imputation credit system makes for a fairer, simpler and lower tax environment.