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Ref: AMK

24 July 2015

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

Email: bettertax@treasury.gov.au

Dear Members of the Tax White Paper Task Force

RE: THINK: TAX DISCUSSION PAPER

Thank you for the opportunity to provide our submission on your discussion paper titled "Re: Think Tax Discussion Paper" (**the Discussion Paper**).

Pitcher Partners is one of the largest accounting firms outside of the Big 4 and has specialised in advising taxpayers in what is commonly referred to as the middle market for over 24 years.

We have made this submission due to (mainly) our significant and growing concern that submissions provided to the Members of the Tax White Paper Task Force (**the Task Force**) to date have not been focused on clear systemic options for tax reform that will provide red tape and compliance reductions for the majority of taxpayers in the country, particularly those in the middle market. We are concerned with submissions that have focused on isolated measures for reform, which in our view are likely to create further complexities and compliance concerns over time.

We first highlight that we do not believe that middle market taxpayers have been identified adequately in this review by any party. While many equate 'the middle market' with relatively small businesses and taxpayers, this does not reflect the breadth and scale of the middle market in Australia.

As commonly understood by professional advisors and the taxpayers themselves, the middle market is a diverse group of taxpayers comprised of privately owned entities and their owners, regardless of size.

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We highlight that this focus on privately owned entities is a common feature of the income tax legislation – and often a source of significant compliance costs. (The most well-known and problematic example of such a provision is Division 7A, which affects privately owned companies.) These provisions generally operate irrespective of whether the relevant taxpayers are small or large.

We highlight that the aggregate size of the middle market taxpayer group is as large and significant as public groups in Australia. The middle market in Australia incurs more employment costs than the aggregate of all public companies in Australia. It contributes to over 38% of total corporate tax revenue collections.

However, the middle market also faces disproportionately high complexity and compliance costs when compared to public groups, which is holding back this vital part of Australia's economy. The middle market also faces different commercial considerations to public groups, such as: limited access to finance; asset protection issues; family succession issues; privacy of information; and the reduced capacity to access advice.

Thus, in our view, it is critical that the White Paper review properly identifies the group of taxpayers commonly referred to as the middle market, in order to understand the overall policy settings and compliance costs that currently affect this group, as well as the opportunities for unlocking its potential.

Systemic issues need a systemic solution

The tax reform process should seek to identify the key *systemic* issues that are the root cause of complexity and compliance costs for most taxpayers.

In our submission, we highlight that a lot of the complexity associated with tax provisions stem from the way in which different types of income are taxed under our current system. We currently have a system that seeks to tax income sources and tax structures on an item by item basis, taking into account the legal form of the item. This type of system has been around since the commencement of the 1936 Tax Act.

Essentially, this form of taxation gives rise to a web of interactions and often contradictions depending on the way the income is classified and the structure used to derive that income. Where structures involve multiple legal forms of entities, the complexity becomes exponential. This has given rise to significant taxation issues associated with provisions such as Division 7A. In our view, the focus of our tax system on income types and tax structure is the single most important structural deficiency in our system that is driving compliance and complexity for middle market taxpayers.

In addition to this, there are a number of other systemic issues which can be summarised as being attributed to: provisions that are drafted with unnecessary complexity for smaller (less sophisticated) taxpayers; a lack of appropriately targeted incentives that apply in the tax system; an inability for middle market taxpayers to appropriately consolidate their tax affairs; and the complexity associated with applying multiple taxation regimes (for example, direct and indirect taxes). In our submission we have outlined a number of potential solutions to these issues identified.

One option that we put forward in our submission, which we believe could help to eliminate tax biases and dramatically reduce complexity, is moving toward a Dual Income Tax system.

Broadly, the Dual Income Tax system aims to treat income based on its economic substance, regardless of the legal form. As a result, tax structure and tax rate biases can potentially be eliminated, thus simplifying the application of the tax system for middle market taxpayers (and millions of individuals).

Moving toward a Dual Income Tax system will require a holistic review of the tax rates and concessions that apply to different entities and different types of income. To achieve the Government's objective of lower, simpler, fairer taxes – and to maintain Australia's international competitiveness – marginal rates on some forms of income may need to fall.

In our submission, we provide an example of how such a Dual Income Tax system could be implemented in Australia. Drawing on publicly available data, we have attempted to broadly estimate the costs of various tax rate changes to show that our approach is feasible.

We recognise that such a change would have substantial revenue and other implications that would need to be independently estimated and considered by Government.

Nevertheless, as there are potential significant benefits to the tax-transfer system that could be achieved through moving toward a Dual Income Tax system – in particular, simpler and more efficient taxes – we believe that this review should seriously consider this option as part of a potential package of reform.

Unless the Tax White Paper considers plausible systemic solutions that can address issues and reduce complexity for the middle market, it will be difficult if not impossible to achieve lower, simpler, fairer taxes and unleash Australia's economic potential.

In our experience, targeted changes designed to simplify and improve specific parts of the tax law often result in significant complexities in other parts of our system due to the interconnection of all parts of our tax system.

We have provided a detailed submission on all of the points outlined above. We would be more than willing to discuss these issues with the Task Force and would be happy to work with you on any proposals that affect the middle market.

Please contact either of us on (03) 8610 5170 (Alexis Kokkinos) or (03) 8610 5503 (Theo Sakell).

Yours sincerely



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