STATEMENT OF REFORM PRIORITIES

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ORGANISATION
KPMG

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STATEMENT OF PRIORITIES

Introduction

The three pillars – productivity, population and participation – and their accompanying challenges and opportunities are key themes that underpin recommendations of Australia’s future tax system, Report to the Treasurer, December 2009 (the Henry Review). The Henry Review provides an understanding of our current position and a blueprint for Australia’s future tax system.

Although the Henry Review provides a long term vision, it does not provide specific details on the implementation design of the recommendations, comprehensive tax reform packages and timetables for reform.

Given current global economic conditions, we are mindful of the fiscal constraints that exist both now and into the immediate future. This will inevitably involve trade-offs in the implementation of tax reform options. However, economic challenges make reform to promote growth all the more compelling.

We appreciate the Government’s initiative in supporting the October Tax Forum to obtain a broad cross section of views and to decipher priorities for reform of Australia’s tax and transfer systems.
All references below to recommendations are to those contained in the report of the Henry Review.

1. **What are your priority reform directions for the tax and transfer system?**

We believe the priority reform directions for the tax and transfer systems are as follows:

**A pathway for tax reform**

We believe the critical factor to achieve successful tax reform in Australia will be a clear roadmap of the process for tax reform following the October Tax Forum.

Achieving tax reform objectives can only be done through a collaborative and consultative approach by the government.

To ensure the momentum for tax reform is sustained for years to come, we believe a government-supported, well-resourced independent body should be established with the capabilities to undertake tax reform research, model the economic efficiency gains and the budgetary impacts of reform options and engage in consultation processes (Recommendations 131 and 134).

The aim of this body would be to progress a ‘whole of government’ approach (including both Federal and State governments), to advance reform options for the tax and transfer systems with unconstrained terms of reference. This body would develop, consult, cost, prioritise and report to Parliament on a whole-of-system reform program for the tax and transfer systems. Its role would also be to stimulate debate on tax policies that are best placed to influence broader public policy outcomes in Australia and to facilitate informed decisions.

In addition to the independent body’s primary role as set out above, we envisage the body’s other responsibilities include improving communication with the public on the tax and transfer systems so as to improve their transparency. For example, the body might be involved in the preparation of periodic tax and transfer analysis statements that analyse and report on the overall performance and impact of the systems, including estimates of efficiency costs and distributional impacts systematic collection and dissemination of tax and transfer data (Recommendations 132 and 133).

**Aspirational ‘tax mix’ for the 21st century**

Australia should concentrate its future tax system on four robust and efficient broad-based taxes – comprehensive personal income; comprehensive business income; broad private consumption and location-based economic rents on natural resources and land. Unless other taxes serve a particular purpose beyond revenue raising, all other taxes should ideally be abolished (Recommendation 1).

Focussing on these four tax bases raises the question of the optimal tax mix Australia should aspire towards in the long run. The relative weighting of the four tax bases should seek to maximise higher levels of economic growth which are needed to drive increased tax revenues (after administration costs), without necessarily increasing the tax burden on taxpayers, and in turn, relieve future pressures due to emerging demographic trends. The role of consumption taxes in Australia’s aspirational tax mix is a key issue requiring greater informed debate and consensus.
Personal taxation

- We support a review of the personal tax system to make it much simpler and more transparent, including the ability to deliver a ‘default tax return’ for a sizable proportion of individual filers (Recommendations 2 and 123).

We also support establishing aspirational targets in respect of personal tax rates following the introduction of a carbon tax and an assessment of proposed options to reach such targets. For example, the effects of moving towards indicative personal tax rates, as set out in the Henry Review (a simple progressive tax rate structure of around 35 and 45 percent with a high threshold of $25,000) are unclear (refer attachment for a personal tax rate scale comparison). Therefore, we support further modelling of potential personal tax rate options.

In line with the objective of improving workforce participation, this modelling would include considerations of the tax and transfer systems interactions and whether current personal tax concessions should be redistributed and/or traded off for lower personal tax rates in a revenue neutral manner.

- We support a review of the current fringe benefits tax (FBT) regime to identify ways to simplify the system. We envisage the review would be undertaken in two stages.

The first stage would involve a review of the scope and the associated compliance costs of the existing fringe benefits regime.

The second stage would involve consideration of proposals such as including fringe benefits in the employees’ taxable income (Recommendation 9).

We observe the Henry Review appears to favour a dual system approach to FBT. That is, if fringe benefits are readily valued to the individual, the employee should be taxed, but other fringe benefits should remain taxed at the employer level. We question the efficacy of a dual approach to taxing fringe benefits and, in particular, whether it would deliver benefits of simplicity.

- The Government announced a discount of 50 percent in the interest included in taxable income capped at interest of $1,000 per annum. Whilst this proposal is a step towards a more neutral treatment of personal savings, we believe further reforms are needed across a range of savings products (Recommendation 14) if there is to be a substantive change in savings patterns. An evaluation is needed of what options exist and what trade-offs against existing investment/saving tax concessions are required to fund a more comprehensive solution.

Transfer system

- We believe the transfer system should be adequate, well targeted and carefully designed to provide a strong incentive to participate in the workforce.
We support a review of the transfer system, in relation to child care assistance, that aims to facilitate both workforce participation of parents and also, to support access to quality child care to foster early childhood development (Recommendation 99).

Further, a review of the transfer system should address obstacles to labour-force participation with an increasing shift towards a ‘sandwich generation’ - a generation of people who care for their ageing parents while supporting their own children.

- We support a review of issues related to the tax and transfer systems that occurs in tandem with the proposals contained in the Productivity Commission’s report on aged care (Recommendations 109 and 110).

- The Henry Review noted there were around 40 Australian government assistance payments. We support a review that seeks to simplify the administration of the transfer system.

**Retirement incomes**

- The Government proposed a different strategy for superannuation reform following the release of the Henry Review, by announcing a proposal for a phased increase in the superannuation guarantee from 9 to 12 percent by 2019-20.

- We support proposals that seek to further improve the retirement income system given the challenges Australia faces in respect of the high costs of an ageing population, late age care and aged related disability. We believe the challenge now will be how to integrate the announced proposals with the Henry Review recommendations (Recommendations 18 to 22), or variations thereof, to ensure there is a more coherent and complete retirement income policy.

- Other options that warrant further analysis include, consistent with the Henry Review, the availability of deferred annuity products or a longevity insurance mechanism to fund health and aged care (Recommendations 21 and 22).

**Business and state taxes**

- The company tax base and company tax rate need to be considered together in considering reform options for company taxation. In line with the objective to improve global competitiveness and economic growth, consideration should be given to further lowering the corporate tax rate and redistributing current tax concessions for companies in a revenue neutral manner. A lower corporate tax rate across the board would assist many businesses, particularly in light of pressures of a patchwork economy and ensure that biases are not created in particular business sectors (Recommendation 27).

- We support recommendations 33 and 34 that focus on targeted reductions to interest withholding tax and we consider that the equipment royalty withholding tax regime may warrant a similar consideration, revenue constraints permitting.
We support a review of other tax reform options that seek to optimise growth strategies for Australia given the growth in economies in Asia, such as China and India, and the increasing competition for global capital. This may include rapidly proceeding with recommendations in The Australian Financial Centre Forum (Johnson) report.

A review of the strategic processes that focus on modernising and improving the tax treaty network with Asia has merit. Consideration should also be given to whether government agencies such as the Australian Taxation Office (ATO) can further assist Australian businesses in managing their cross border tax compliance obligations by better leveraging the growing international relationships between tax administrations.

Options need to be considered to replace narrowly based and inefficient State taxes. We support a proposal that seeks to further harmonise State tax regimes. A single payroll tax regime administered on a national basis should be considered in the short to medium term. In the long run, Australia should aspire to the eventual abolition of payroll tax and replacing it with a more efficient revenue base (Recommendations 57 and 119).

**Tax system governance**

The identification of technological opportunities to better support automated reconciliation of tax affairs for individuals and business, to improve the client experience of the tax and transfer systems (Recommendations 122 to 131) should be actively supported.

We support a proposal that provides the ATO with access to the expertise of senior business executives as well as strengthens the accountability of the ATO to its key stakeholders, by establishing an oversight board, with an independent board of directors (variation to Recommendation 115).

We support proposals that seek to improve the quality of tripartite tax law design in particular improving the quality of consultation interactions. Further investigation should be carried out as to whether a less frequent tax legislative amendment process (or indeed a United Kingdom style annual tax bill process) would produce better tax law and tax compliance outcomes.

The production of a single income tax assessment act should be a short term goal. We also need to evaluate the longer term optimal framework for tax acts within a Federated tax system.

In the context of optimal frameworks, there are opportunities to improve the taxation system by focusing on some of the interpretational challenges of tax law design. It is often said taxpayers require certainty in the law. However, this can result in a tax design model where a small difference at the factual margin can make a huge difference to tax outcomes. This in fact creates a dispute prone tax system, ironically removing the certainty that was intended.
For example, the exact type of intangible asset acquired by a business can be the determining factor in establishing the period over which deductions are claimed. A tax design model that sought to achieve certainty within tolerances (i.e. a standard deviation methodology), perhaps linking more to accounting concepts in a range of areas, might achieve an overall efficiency gain to the system.

**Environmental and social taxes**

- We support the Henry Review recommendations of only introducing taxes in addition to the four broad bases if they improve market or social outcomes and are found to be a better means of achieving a desired outcome than other policy instruments. For example, we support a proposal that reviews the efficacy of road transport taxes to address Australia’s future transport and infrastructure challenges (Recommendations 1 and 65).

- We also support a proposal that seeks to reduce the number of taxes that distort production decisions or add to production costs. The reduction of the number of taxes would facilitate the automation of tax administration, reducing business compliance costs (Recommendation 1).

2. **How are your proposals financed over the short and longer term?**

We acknowledge the medium term fiscal constraints and the need for tax reform proposals to be broadly revenue neutral.

Some of the proposals we have identified above, in particular in relation to personal, business and state taxes, we have acknowledged that a reconsideration of existing tax concessions or a rebalance the taxation mix may be necessary pre-requisites to medium term tax reform.

In relation to all tax reform ideas identified as part of the October Tax Forum, we support a proposal of an independent body undertaking further research on the design and costing of such tax reforms to ensure they can be implemented in an affordable manner. Tax reform priorities are likely to be given to affordable proposals that best support broader public policy objectives around productivity, population and participation. In short, this tax reform pathway would enable an enhanced understanding of the implementation implications for a range of tax reform options to be developed in a manner that is both consultative but also realistic in terms of revenue constraints.

**LIST OF ATTACHMENTS**

- Personal tax scale comparisons – pre and post carbon tax vs Henry Review indicative scales
## Personal tax scale comparisons

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<tr>
<th>Taxable income $</th>
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<th>Taxable income $</th>
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<tbody>
<tr>
<td>0 - 6,000</td>
<td>Nil</td>
<td>0 - 18,200</td>
<td>Nil</td>
<td>0 - 25,000</td>
<td>Nil</td>
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<tr>
<td>6,001 - 37,000</td>
<td>15%</td>
<td>18,201 - 37,000</td>
<td>19%</td>
<td>25,001 – 180,000</td>
<td>35%</td>
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<td>37,001 - 80,000</td>
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<td>37,001 - 80,000</td>
<td>32.5%</td>
<td>180,001+</td>
<td>45%</td>
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<td>80,001 - 180,000</td>
<td>37%</td>
<td>80,001 - 180,000</td>
<td>37%</td>
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<tr>
<td>180,001+</td>
<td>45%</td>
<td>180,001+</td>
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Low income tax offset (LITO) scale comparison and effective tax-free threshold

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<td><strong>Threshold</strong></td>
<td><strong>Rate</strong></td>
<td><strong>Threshold</strong></td>
<td><strong>Rate</strong></td>
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<tr>
<td>Up to $1,500</td>
<td>4% withdrawal rate on income over $30,000</td>
<td>Up to $445</td>
<td>1.5% withdrawal rate on income over $37,000</td>
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<tr>
<td>Effective tax free threshold</td>
<td>$16,000</td>
<td>Effective tax free threshold $20,542</td>
<td>Effective tax free threshold $20,979</td>
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</tbody>
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**References:**

[1] Tax rates 2011-12 for residents only. The above rates do not include the Medicare levy of 1.5% or the Flood levy. *Source:* Australian Taxation Office website.

[2] In addition, the tax-free threshold is proposed to increase to $19,400 from the 2015-16 income year following the introduction of the carbon price and the 32.5% marginal tax rate moves to 33%. *Source:* Joint Media Release of Deputy Prime Minister and Treasurer (No.81) *Combining Tax Cuts with Significant Tax Reform*, 10 July 2011