

# TIME FOR A RE:THINK ON TAX REFORM

CPA Australia's submission in response to the Re:Think Tax discussion paper

June 2015

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BE HEARD.  
BE RECOGNISED.



## Foreword

The Australian Government's Tax White Paper should squarely focus on outcomes that enhance Australia's competitiveness – the ability to encourage investment, consumption, and savings, job creation, and improved standards of living. It should not be just about shoring up flagging tax revenues.

CPA Australia is committed to tax reform that will enhance Australia's competitiveness, and we remain a leading advocate of the need for a package of interconnected tax reform measures, rather than a series of standalone reforms.

The linchpin to any significant and sustainable tax reform in Australia is to move Australia's tax mix away from its over-reliance on income taxes on both companies and individuals – towards taxes on consumption, and in particular the goods and services tax (GST).

Australia must also address the numerous taxes imposed by all levels of government when only ten of the 125 taxes collect around 90 per cent of the revenue.

Earlier this year CPA Australia released its landmark study 'Tax Reform in Australia– The Facts'<sup>1</sup> that considered the economic and tax impacts of a number of scenarios where the GST was used to fund the abolition of a number of inefficient state taxes, plus provide individual income tax cuts and welfare payments.

This research forms a substantial part of our Re:think submission. However as insightful as it is, it is still only one component of what the tax reform agenda must consider, and on which it should deliver.

There are many factors at work in the economy at any given time, and there are other taxes that require reform if we are to make Australia more competitive, create jobs, raise living standards, and provide governments with stable and growing revenue streams that are more resilient external shocks.

CPA Australia's submission is a ten-point plan for a better tax mix for Australia. It is set out in two related parts:

- Part A – sets out a package of reform measures, including certain features of those reforms we encourage the Government to collectively model for their economic, social and revenue impacts and present as options in the forthcoming Green Paper later this year, and
- Part B provides comments and recommendations on other important issues raised in the Re:think discussion paper.

We encourage the Government to use the Green Paper to explain the need for reform by clearly articulating its vision for the economy and society and show how the current policy settings will fall short of enabling Australia to succeed in achieving that vision. We also encourage the Government to set out what it believes are the key features of the tax system necessary to help achieve that vision.

We also encourage the Government to use the Green Paper to put forward packages of appropriately modelled reform options as was done in the Reform of the Australian Tax System Draft White Paper in 1985 rather than simply listing what may appear to be mutually exclusive reform options. One option that must be modelled and included in the Green Paper is the 'do nothing' option, so that the community has a base on which to compare the various reform proposals.

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<sup>1</sup> <http://www.cpaaustralia.com.au/documents/tax-reform-in-australia.pdf>

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We believe that this holistic approach to reforming the tax system is critical to ensuring the calm and rational discussion we need about the best tax mix for our country.

If we can put aside self-interest and come together as a community I am confident we can frame a tax system that's simpler, enhances the competitiveness of our businesses, incentivises innovation, lifts flagging revenues and builds resilience against future shocks - while maintaining a core of equity and fairness.

A handwritten signature in black ink, appearing to read 'Alex Malley', with a stylized flourish at the end.

Alex Malley FCPA  
Chief Executive

## About CPA Australia

CPA Australia is one of the world's largest accounting bodies with a global membership of more than 150,000 members working in 120 countries around the world, with more than 25,000 members working in senior leadership positions.

We have a history that stretches back to 1886, and have been actively involved in Asia since the early 1950's. We currently have nine offices in Asia and more than 36,000 members working in the region.

CPA Australia is committed to a creative engagement with governments and their agencies on behalf of members and in the broader public interest to encourage the adoption of economic and social policies that foster improvements in Australia's productivity and global competitiveness.

## PART A

In Part A we set out our preferred package of reform areas and some of the key features for each of those areas. We encourage the Government to model the economic, social and revenue impacts of these reforms as a whole for the forthcoming Green Paper, rather than modelling each reform separately. Our preferred reform package includes the following reforms:

1. A greater reliance on consumption taxes as our population ages and work and consumption patterns continue to change
2. Abolishing the most inefficient state taxes
3. Lowering the corporate tax rate to be more internationally competitive
4. Lowering income tax rates for individuals
5. A savings income tax discount
6. A reformed capital gains tax regime
7. A reformed FBT regime
8. A reformed superannuation regime
9. A new business entity for SMEs, and
10. Incentives to maintain Australia's workforce.

These elements are discussed further below and should be considered as interdependent rather than as mutually exclusive 'laundry list' of reform options.

### 1. Consumption taxes

CPA Australia is of the view that without changes to the GST, meaningful and sustainable tax reform is not possible. We encourage the Green Paper to include in its package of reform options an increase in the GST rate to 15 per cent and apply the GST to a broader tax base as envisaged in CPA Australia's Tax Reform in Australia – The Facts.<sup>2</sup> This report is included as Attachment 1 to this submission.

The report models different scenarios based on a GST rate of 10 and 15 per cent with tax base changes, with each generating additional GST revenue ranging from \$12.1 billion to \$42.9 billion in the first year of introduction.

The modelling work commissioned by CPA Australia demonstrates that additional GST revenue raised can be used to abolish a number of inefficient state taxes and also provide for personal income tax cuts and compensation for low income households to make it very unlikely that any household would be worse off under each reform scenario, while also boosting economic growth.

The various scenarios will have different impacts on different industries. Naturally if there is no GST on fresh food and health currently, and it is introduced, we can expect a drop in these sectors initially with any impact likely to be short-lived. Even with an increase to 15 per cent, Australia's rate of GST would remain low by global standards, with the average rate across OECD nations at over 19 per cent.

We also encourage the Government to include in the Green Paper a package of reform options where there is no change to the GST. We would expect that the modelling of such an option would show that there is very limited scope to improve the tax system without changes to the GST. We would also expect that such modelling would also show that over time, the revenue base of both the federal and state governments will weaken as the population ages and consumption patterns shift more towards GST-free items.

### 2. Elimination of the most inefficient State taxes; conveyance duty, motor vehicle and insurance taxes

We refer you to the modelling work undertaken earlier this year and outlined in Tax Reform in Australia -The Facts.<sup>3</sup> This report outlines a plan on how three of the most inefficient state taxes - conveyance duty, motor vehicle and

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<sup>2</sup> ibid

<sup>3</sup> ibid

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insurance taxes – could be reduced or abolished with the benefits of increasing GDP, simplifying the tax system and providing the states with more stable and growing revenue source at the same time.

Transaction taxes like conveyancing duty are a disincentive to a more free-flowing property market. Investors tend to hold property longer, and new entrants to the property market – both commercial and residential – are discouraged from investing because of the high transaction costs imposed.

We note that the removal of stamp duty on marketable securities such as shares - as part of the Australia's New Tax System (ANTS) in 2000<sup>4</sup> encouraged investment in the Australian share market. The challenge is how conveyancing duties on real property could be reduced or removed in an equitable manner, and also how such a move could be funded.

The Australia's Future Tax System (AFTS)<sup>5</sup> proposed as one of its framing principles that taxes should be low on mobile capital, and higher on immobile capital. CPA Australia is supportive of this principle. It follows then that the Green Paper should model the economic implications of greater land taxes in lieu of conveyancing duty on real property or a reduction in such duty.

The modelling would also need to consider transitional rules such as a gradual withdrawal of conveyancing duty and the introduction of the replacement land tax over a number of years. We understand this is the approach being taken in the ACT as it shifts towards greater reliance on land taxes.

We note the concerns raised over the impact on lower income households of increasing land tax. We suggest that in modelling the scenarios around reducing conveyancing duty and increasing land tax that the Government also model the impact of such a change on households from differing income groups. This will give the Government more data with which to consider appropriate policy responses to reduce or address any identified inequity.

We also recommend that any potential compensation mechanism that may be considered be separate from the tax system. Using the tax system to deliver welfare outcomes through for example, exemptions adds complexity to the tax system, and is considered by many to not be the best approach to addressing any identified inequity. The AFTS supports this view, stating that "Some exemptions from land tax may be motivated by equity concerns. In general, land tax is not a good tool for achieving vertical equity objectives. As land holdings are just one asset in a wealth portfolio, they are not a comprehensive mechanism for assessing means. Exemptions based on use are also unlikely to target equity well, as they will reduce tax for people regardless of their means. The income tax transfer system is a more effective and targeted means of achieving vertical equity between Australian residents than exemptions from land tax."<sup>6</sup>

We also note that abolishing conveyancing duty and insurance taxes is also in accord with recommendations 51 and 79 of the *Australia's future tax system – Report to the Treasurer* (the Henry Report).<sup>7</sup>

A copy of CPA Australia's submission (2015, April) to the South Australian Government's Tax Review is enclosed as Attachment 2 to this submission.

### 3. Corporate tax rate – a lower corporate tax rate

There is clear evidence that reducing the tax burden on businesses lifts productivity, and increases both their competitiveness and their capacity to expand, and creates jobs. Further, the tax incidence of higher company taxes falls on workers as lower wages. For these reasons we support a lower corporate tax rate.

Reducing the company tax rate is crucial in a global marketplace where many competitor jurisdictions have reduced their corporate tax in order to both retain business and attract new investment. Australia's current headline corporate tax rate of 30 per cent is simply not competitive.

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<sup>4</sup> <http://archive.treasury.gov.au/documents/167/PDF/overview.pdf>

<sup>5</sup> [http://taxreview.treasury.gov.au/content/content.aspx?doc=html/pubs\\_reports.htm](http://taxreview.treasury.gov.au/content/content.aspx?doc=html/pubs_reports.htm)

<sup>6</sup> [http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final\\_Report\\_Part\\_2/chapter\\_c2-2.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_c2-2.htm)

<sup>7</sup> [http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final\\_Report\\_Part\\_1/chapter\\_12.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final_Report_Part_1/chapter_12.htm)

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The Henry Report<sup>8</sup> suggested 25 per cent corporate tax rate as target. We support this as a short to medium term target.

We suggest the Green paper model the economic and revenue impacts of lowering the company tax rate to 25 per cent. We also recommend that the Green Paper also model a 20 per cent rate to see if that is achievable and desirable.

We recognise that such a move comes at a cost to the revenue in the early years although there is a dividend in the out-years as a consequence of greater economic activity.

We encourage the Government to look at tax reform options holistically rather requiring for example, a company tax cut be funded only by reductions in tax measures that favour companies.

As part of developing a package of reform options, the Government could consider whether it would be advantageous in the context of the overall reform package that the current tax measures in the favour of companies and other taxpayers be maintained, extended, reduced or removed.

While expressing no view on the following, tax measures favourable to companies that the Government could consider as part of its Green Paper include:

- Exemption from interest withholding tax on certain publicly offered debentures and debt interests
- The immediate deductibility of expenditure on exploration or prospecting including the cost of depreciable assets if the taxpayer first uses the asset for exploration or prospecting for minerals or quarry materials
- The statutory effective life caps and the capital works expenditure deduction, and/or
- The non-refundable tax offset for research and development.

### 4. Lower marginal tax rates for individuals and unincorporated businesses

CPA Australia has been a long-term advocate of the need to reduce Australia's personal tax rates to benefit individuals, unincorporated businesses and the broader economy. We encourage the Government to model the economic, social and revenue impacts of implementing the aspirational personal tax rate scale announced in the 2008/09 budget, being 15 per cent, 30 per cent and 40 per cent, with an enhanced low income tax offset to replace the current zero rate threshold.<sup>9</sup>

We suggest that for the purpose of modelling, the thresholds for each band be set to achieve a targeted percentage of taxpayers in each band, similar to the targets former Treasurer Costello's set in a press release on personal income tax reform on 15 October 2007<sup>10</sup>. For instance, only two per cent of taxpayers should pay the highest marginal rate and 15 per cent pay the second highest rate.

In deciding on the personal tax rates and thresholds to model, the Government must consider their impact on Australia's competitiveness in comparison to our regional competitors and their influences in attracting and retaining mobile professionals.

Our views in the regard are reflected in the CPA Australia commissioned landmark publication on Australia's competitiveness by professors Michael Enright and Richard Petty. In that publication the authors point out amongst other things that Tax rates and the distribution of tax burdens are social choices, but Australia does not exist in a vacuum, and so it must assess the impact of tax rate differences on mobile professionals and companies. Australia should take the competitiveness implications of different tax options into account when making choices.<sup>11</sup>

It would also be appropriate to model the removal of the Medicare Levy, particularly given that the levy funds only a small fraction of the Commonwealth's total health expenditure and thus cannot be seriously considered as a properly functioning hypothecated tax.

<sup>8</sup> [http://taxreview.treasury.gov.au/content/finalreport.aspx?doc=html/publications/papers/final\\_report\\_part\\_1/chapter\\_12.htm](http://taxreview.treasury.gov.au/content/finalreport.aspx?doc=html/publications/papers/final_report_part_1/chapter_12.htm)

<sup>9</sup> Page 10 2008-09 Budget Overview [http://www.budget.gov.au/2008-09/content/overview/html/overview\\_10.htm](http://www.budget.gov.au/2008-09/content/overview/html/overview_10.htm)

<sup>10</sup> <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2007/108.htm&pageID=003&min=phc&Year=&DocType=0>

<sup>11</sup> Pg 251 Enright, M and Petty, R 'Australia's Competitiveness – From Lucky Country to Competitive Country Wiley 2013

## 5. A different approach to taxing income depending on source

### *Income from savings*

Major reform of Australia's tax system requires a review of how income from different sources should be taxed. Our current system effectively penalises taxpayers on income derived from savings outside the superannuation system.

Given the tax-preferred status of superannuation, it has become the preferred savings vehicle for most Australians.

This is beneficial for retirement savings, but does little to recognise the necessity for individuals to save income outside of super to afford major capital purchases during their working lives. If income derived from savings was taxed at a rate that was lower than an individual's marginal personal tax rate, this would encourage greater savings and investment outside of the super regime also.

Such an initiative may also provide an opportunity to reduce or even remove the CGT discount currently available to individuals.

Further, it would also make the gearing - particularly negative gearing - of investments less economically attractive - but at the same time still encourage investment in housing, and help improve housing stock.

Recommendation 14 of the Henry Report proposed that there should be a 40 per cent savings income discount available 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.

We support this proposal being part of the package of options modelled for the forthcoming Green Paper.

### *Business income*

Business income is taxed at different rates depending on structure rather than type of income. Arguably business income should be taxed the same regardless of structure used.

Lower taxes on business income may provide an opportunity to reduce imputation without the same consequences investors would face if imputation was removed and not replaced with an appropriate alternative.

We propose the Green Paper process should consider an income tax model where business income, regardless of the entity through which it is earned be taxed at the prevailing corporate tax rate.

### *Dividend income*

Australia's full imputation system has delivered significant benefits to Australian investors and the economy since its introduction some decades ago. These include increasing national savings through encouraging greater investment in Australian companies by individuals and superannuation funds, enhancing companies' ability to raise capital, compete and create jobs, and enabling companies to rely on equity rather than debt for business investment and expansion.

However the public debate on whether we should keep the full imputation system continues and it is appropriate that this be considered as part of the reform process. In the main the public positions promulgated are at either end of the spectrum, that is, Australia should either have a full imputation system, or Australia returns to 'the bad old days' of the full classical system of double taxation of dividends.

As pointed out in the Review of Business Taxation's 'A Strong Foundation' discussion paper<sup>12</sup> "the introduction of dividend imputation responded to the then effective higher rate of tax on income earned through a company and distributed to individual shareholders as dividends. Prior to 1987, the total tax rate on company income that was distributed as a taxable dividend to an individual shareholder on the top marginal tax rate could be as high as 78.4 per cent. Subsequent policy design responses to dividend streaming, franking credit trading and company tax rate alterations, amongst other factors, have transformed the initial imputation regime beyond recognition."<sup>13</sup>

<sup>12</sup> <http://www.rbt.treasury.gov.au/>

<sup>13</sup> Ibid, at para 2.5

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However, the Henry Report noted “the bias for households to over-invest in certain domestic shares has increased”<sup>14</sup> due to the imputation system. With the population ageing and generally low returns on other major investments such as rent and interest, this bias would have compounded in the few years since the Henry Report and will only increase further in future years.

The Henry Report<sup>15</sup> also points out that as non-resident shareholders cannot directly benefit from imputation credits whereas resident shareholders can, this creates incentives for companies to stream unfranked dividends to non-residents and franked credits to residents and for franking credit trading to take place. The response to these actions has been for the parliament to implement complex anti-avoidance provisions. However we note that the effectiveness of such measures is somewhat limited as they do not prevent streaming through dual-listed entities.

In spite of these flaws to dividend imputation, CPA Australia does not support the replacement of the current dividend imputation system unless there is found to be a more appropriate alternative – one that does not act as a disincentive to investing in listed entities. The Review should therefore consider and model alternatives to the current imputation system to see if they are superior to the existing system. Review may also wish to consider dividend streaming by dual-listed entities.

We understand that in some other jurisdictions, for example Hong Kong and Singapore, dividends are not taxable in the hands of individuals.

Alternatively should dividend income be subject to the same 40 per cent discount discussed under “Income from savings” above, and as per the Henry Report?<sup>16</sup> Further, we also note that in China dividends are taxed at a discounted rate.

The tax system should not discourage investment in Australian business for the benefit of both businesses and their shareholders, as such the Green Paper should propose alternatives to the current system to see if such alternatives are superior to what is currently in place.

### *Income from rents*

Earlier in this submission, we provided comments on the possible future treatment of income from savings, including rents, above. However due to the ongoing public commentary regarding negative gearing we wish to put the following comments and observations on the record.

The public debate about negative gearing seems to be mainly about the affordability of housing and usually not much else. In this regard it is often a highly emotive – and misunderstood concept. There are few commentators if any who regularly publicly criticise negative gearing of other investments – such as a small business, or a commercial property, or even negatively gearing an individual’s share portfolio.

Investing in anything involves varying degrees of risk. Any investor negatively gearing a property is effectively gambling that at some time in the future the real gain made on disposal of the property will be greater than the economic loss they have already experienced - including income forgone – over the time they held the actual property.

For many investors these investments form part of their overall retirement savings whether in or outside the super regime. Many of these investors may ultimately be making nominal gains - but losses in real terms - on their investments, given the very low gross yields on residential property rents.

We need to encourage and not discourage investment. We need to encourage savings in and out of the super regime.

Winding back the ability of investors to negatively gear investments -by way of specific legislative measures or otherwise - on residential property or more broadly – will have significant investment implications for investors who already have a limited range of investments in which to invest.

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<sup>14</sup> [http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final\\_Report\\_Part\\_1/chapter\\_12.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final_Report_Part_1/chapter_12.htm) see recommendations 16 and 27

<sup>15</sup> [http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final\\_Report\\_Part\\_2/chapter\\_b2-3.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_b2-3.htm)

<sup>16</sup> Recommendation 15 Henry Report – see [http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final\\_Report\\_Part\\_1/chapter\\_12.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final_Report_Part_1/chapter_12.htm)

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CPA Australia does not support the winding back of negative gearing on any of these types of investments – residential property, commercial property, small business or investors' share portfolios.

We are of the view that housing affordability is a significant issue, however it seems to be mainly one of supply, and one that requires a non-income tax driven response.

### 6. A reformed capital gains tax regime

The current system of taxing capital gains (CGT) is, in the main, supported. In particular the small business CGT rules remain very important to ensure appropriate reward for risk, and enabling small business owners to have funds for their retirement. As was recognised when these measures were initially introduced, often small business owners will invest in growing their business during their working lives, and not put money into superannuation unlike employees who at least have SGC contributions.

Notwithstanding the above comments we encourage the Green Paper process to consider and model a small business CGT regime with increased thresholds and a simplification of the maximum net asset value test.

Regarding the CGT general discount – we propose the Green Paper consider options on whether there is an opportunity to replace it with a more general discount on savings income or profits – see the discussion under the heading "Income from savings" above.

### 7. Superannuation and retirement savings

Superannuation is the primary retirement savings vehicle for the majority of Australians, so it is appropriate that tax concessions are used as a policy lever to provide an incentive, encourage desired behaviour and compensate individuals for locking their savings away in the superannuation system.

However, there has been considerable public debate recently about the quantum, distribution and equity of the tax concessions provided to superannuation. Further, successive governments have made changes to the taxation treatment of the superannuation regime to shore up flagging revenue.

Two recent examples of this are the 2014 deal to repeal the mining tax included repealing the Low-Income Superannuation Contribution and delaying the increase of the Superannuation Guarantee to 12 per cent. Constant rule changes and revenue grabs undermine public confidence in the system, which may have negative impacts on Australia's long-term savings

Further, with the tightening of the age pension eligibility tests announced in the 2015-16 Federal Budget, more retirees will have to rely on their superannuation to maintain even a modest lifestyle in retirement. It is therefore more important than ever that the policy levers, including taxation are set appropriately to help ensure superannuation provides adequate retirement savings.

The removal of end benefits tax from age 60 may have been appropriate at the time of its announcement as a short term measure as current and imminent retirees had not had access to a mature SG system. However, as the system matures it may be appropriate to rethink this position and consider shifting some of the tax burden from the contributions phase to the benefits phase, albeit with a long transition phase.

Ideally, the most equitable retirement savings system would tax income in the hands of the individual when it is actually received. That is, contributions would be tax exempt, fund earnings would be tax exempt or concessional taxed, and benefits would be taxed. What is known as the EET model (exempt, exempt, taxed) is the most common taxation model used in the majority of OECD countries. Australia is unique in taxing retirement savings at all three points.

We propose the Re:think review consider what it would mean to a shift to an EET system, and model the economic, social and revenue impact of a transition to such a system including the age pension implications.

However, the taxation of superannuation cannot be considered in isolation. There must first be a long-term vision and objectives for our retirement savings system. The Financial System Inquiry recommended the development of objectives for the superannuation system and enshrining them in legislation. However, developing an effective retirement savings policy is more than just developing objectives for superannuation, it must also encompass the age pension, non-superannuation investments and the family home, employment and aged care.

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In conjunction with the Re:think review considering the prospects of a shift to an EET system of superannuation taxation, we believe the Government must first develop a long-term retirement savings policy that encompass superannuation, the age pension, non-superannuation investments, the family home, employment and aged care.

It is also imperative that superannuation and retirement savings policy are removed from the political cycle and bipartisan support given to our long-term retirement savings goals. We believe there is merit in the establishment of an independent body to oversee retirement savings policy and further consideration should be given to this.

### 8. A new entity for small business

The Re:think paper discusses the virtues of a US 'S-Corp' type entity for SMEs in Australia. This is along the lines of something our organisation has advocated for many years.

As such we believe that it would be appropriate for a new type of entity be introduced into our tax regime that would have some of the features similar to that of a S-Corp, such as limited liability and streaming/ flow through of income to beneficiaries, but importantly it would also need the additional feature of being able to retain income that would be subject to income tax at non-punitive rate.

The thinking behind this is that at present a typical and relatively ordinary commercial family business structure would involve:

1. a corporate trustee
2. a discretionary trust, and
3. discretionary beneficiaries including a corporate beneficiary.

The introduction of a new entity that has the features of limited liability, allows income streaming like a discretionary trust, allows income retention and is taxed at the prevailing company tax rate – would potentially eliminate the need for three entities, reducing the entity structures required in this example from three to one.

The idea of a new SME entity should not be confused with the proposal from Review of Business Tax of 'taxing all trusts as companies' over a decade ago. The Board of Taxation's review of the so-called entity tax regime appropriately put that proposal to rest. That proposal remains inappropriate when one consider the myriad of different types of trusts with differing objects (such as child maintenance trusts) and the perverse outcomes that would result from such a measure.

Certainly the introduction of a new entity may add to complexity. However it may be one small step that enables a tidy-up of much of the complexity small businesses continually face relating reinvestment of business profits in a business and the private company loan/ deemed dividend rules, amongst other things.

### 9. Incentives to maintain Australia's workforce

The Australian Government's fourth Intergenerational Report<sup>17</sup> (IGR) shows the challenges that arise from our ageing population. These include more retirees and fewer workers as we move towards 2050 and beyond.

The IGR also introduced many Australians to the important concept of the three P's – population, participation and productivity, and with participation rates expected to decline over time this puts at risk the third P – productivity.

We recognise that this is not only a tax issue, but recommend the Green Paper consider tax incentives to both businesses and older workers to encourage them to stay productive in the workforce longer should they choose to do so.

We acknowledge that Australia already has some existing incentives in place, such as the older worker payment to employers.<sup>18</sup> Further, senior Australians also currently have the benefit of the Senior Australians Tax Offset (SATO) in determining their taxable income each year which reduces the tax on their take-home pay.

<sup>17</sup> <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/2015-Intergenerational-Report>

<sup>18</sup> We note that the Government proposed to enhance this in the 2015/16 Federal Budget

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However CPA Australia encourages this review to consider other options. For example, what would it look like if older workers could work up to 24 hours per week, and that income was tax exempt to them. In other words, the employee would receive tax exempt wages and from an employer point of view, the overall salary paid to such employees would be lower as the employer would not have to withhold tax.

We believe the Green Paper should examine further tax incentives for keeping older workers in the workforce for longer.

### 10. Maintaining the current fringe benefits tax regime

The fact that the fringe benefits tax regime is an anti-avoidance regime is often overlooked by public commentators. CPA Australia's view is that in the absence of a better, more streamlined model of taxing fringe benefits it should be largely left as it is.

Suggestions to move the taxing of fringe benefits to the individual instead of the employer seem more complicated than they may sound at first blush. For example:

- it does not remove the employers' obligation to capture and classify the fringe benefit
- the employer will have the additional task of allocating fringe benefits during the year to the relevant employee, and then adding it to their payment summary
- it means the tax office will, instead of dealing only with those employers who pay FBT, also need to administer FBT for all employees who received a fringe benefit
- to disturb the current arrangements in any significant way will result in significant disruption to current employment arrangements, awards and employee agreements which would need to be revisited and maybe even renegotiated adding to overall business compliance costs and for little benefit to anyone.

In summary, while there are critics of the current FBT regime it has served us well for nearly three decades, and is well entrenched in most business' ongoing financial and compliance processes.

Notwithstanding the above, there may be room for improving its integrity in some areas. For example, it has been brought to our attention that some employees may be able to exploit the annual FBT threshold limit available in some sectors by working for multiple employers. If this is the case this should be reviewed to determine if this was permissible under the original FBT policy intent or not.

## PART B

### Australia as a knowledge economy

As we look ahead, we are clearly seeing a changing Australia. We have an end to the mining investment boom, and the increasing importance of China and Asia more broadly in driving global economic growth.

As a nation, we have the choice to continue with business as usual or chart a new course towards a knowledge-based economy: one which will drive economic growth and create high paying jobs over the next decade and beyond.

In an increasingly competitive and interconnected global economy, we are looking for initiatives which will grow new revenue streams, stimulate the non-mining sectors of the economy and create an environment and system of support that enables businesses to grow.

Now is the time to invest in our future prosperity. Therefore, the Green Paper should explore the value of delivering targeted tax incentives to encourage investment in and the development of the non-mining industries that will create the high-paying jobs of the future including, for example the following industries - pharmaceuticals, telecommunications, medical technologies, fintech and cleantech.

The Green Paper could also consider targeted incentives to encourage the development of high-value added services which take advantage of our time zone and highly regarded professionals, for example the establishment of an e-health services hub for the world.

### Innovation

Embedding an innovative culture throughout Australian businesses is critical if Australia is to raise productivity, improve international competitiveness and create the high paying jobs of the future.

Like most developed economies Australia is simultaneously grappling with various complex and often interdependent challenges including the rise of the digital economy, the reconfiguration of global supply chains, the demise of traditional manufacturing, the volatile impact of climate change and the rapid uptake of new technologies in virtually every sector of the economy.

If Australia is to successfully confront these changes and reap the substantial benefits that will inevitably arise from the new digital and knowledge-based economy, it is essential that the Government implement a holistic suite of tax and non-tax policies to encourage a culture of creativity and entrepreneurship.

We are a nation of innovators so we are not short of ideas. What we do lack, and what is now putting our global competitiveness at risk, is our poor offering in terms of a globally attractive, business-friendly environment.

Such policies need to be robust, comprehensible and stable so that the private sector has more certainty in investing in new technologies, new industries and new skill sets.

Tax policies to encourage greater innovation that could be considered as part of the Green Paper include:

- Patent box - The Government should consider enacting a tax regime based on the recent 'patent box' tax incentive introduced in the United Kingdom. Under such a model, businesses which have significantly invested in the creation of patented intellectual property should only be taxed on any income streams or patented technology arising from the licence and sale of patents at half the prevailing corporate tax rate.
- Reverse recent changes to the R&D tax incentive that caps the non-refundable R&D tax offset for eligible R&D expenditure to \$100 million and below
- Early stage venture capital changes - The eligibility criteria for accessing early stage venture capital limited partnerships be broadened so that the concessional tax treatment available under these structures is extended to any part of the life cycle of an eligible project and funding ceiling for such partnerships be

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increased from \$100 million to \$200 million, and that an entity's maximum investment in a limited partnership be increased from 30 per cent limit to 50 per cent.

### The federation challenge

COAG acknowledged that Australia's overlapping and inconsistent regulations impede productivity growth, and without change Australia's future living standards would be compromised, the competitiveness of the economy reduced and our ability to meet the challenges posed by an ageing population diminished.<sup>19</sup>

Many of the challenges facing the economy can only be addressed through more effective Commonwealth–State arrangements. By moving towards a seamless national economy through the reform of business and other regulation, COAG's reforms will make it easier for businesses and workers to operate across state and territory borders.<sup>20</sup>

A prime example is payroll tax. While payroll tax laws are largely harmonised (except for the rates), how a business's payroll tax liability is calculated varies between jurisdictions. This adds complexity as it requires staff to be familiar with different methods of calculating what they view as the same thing. Moving to single national agency to administer, interpret and enforce various payroll tax laws would significantly reduce overlap and burden. Such a national agency need not be a Commonwealth agency. They could be jointly owned by each of the State and Territory government.

Such a national approach would allow for a single return, using one liability calculation method for all jurisdictions in which a business operates, and one payment. It would then be the responsibility of the national agency to distribute the revenue collected to the appropriate government.

### Trans-Tasman tax issues

It is clear from CPA Australia's consultations in the past that that the number one issue for companies operating across the Tasman is mutual recognition of imputation credits. Imputation credits are used in Australia and New Zealand to prevent the double taxing of company profits in the hands of shareholders, but they only apply domestically. This potentially creates a bias against offshore investment, including across the Tasman.

The fact that this is an issue of long-standing concern suggests that it is not a straightforward matter to address. There are in fact a number of dimensions to it, bilaterally and more widely. In brief, the merits of mutual recognition of imputation credits would seem to depend on:

- the size of investment distortions under the current arrangements
- economic implications of the fiscal shortfall from mutual recognition (including the extent to which this would give rise to new distortions), and
- whether or not either country is likely to move away from a business tax system involving imputation credits in the medium term.

The 2012 Australia/ New Zealand joint Productivity Commissions' review<sup>21</sup> recommended that the Australian and New Zealand governments should either initiate a process, preferably with a clear deadline, for determining whether there is an efficient, equitable and robust mechanism that would ensure a satisfactory distribution of the

<sup>19</sup> <https://www.coag.gov.au/node/291#A> Seamless National Economy

<sup>20</sup> *ibid*

<sup>21</sup> <http://www.pc.gov.au/inquiries/completed/australia-new-zealand/report>

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gains from the mutual recognition of imputation credits (MRIC); or announce that MRIC will not go ahead if they consider that such a mechanism is infeasible.<sup>22</sup>

As pointed out in the joint PC report 'Principally because Australian investment in New Zealand is larger than New Zealand investment in Australia, Australian income transfers to New Zealand would probably be greater than transfers the other way, and Australia is likely to be made worse off.'<sup>23</sup>

Further, the bigger threshold question to consider is whether either country chooses to retain their current imputation systems in the short to medium term at all.

Against this background, it is not appropriate to recommend the adoption of mutual recognition of imputation credits, at least not at this stage. However we do recommend the review consider the issues raised regarding both the potential cost and the future of imputation in both countries. We note this is also consistent with the Henry Report's recommendations.<sup>24</sup>

### **Aligning taxable income and allowable deductions with accounting income and expenses**

Reviews of this type usually - and appropriately - include consideration of whether the income tax system could more closely align with accounting concepts of income and expenses and profit and loss.<sup>25</sup> This is usually on the basis of simplification and compliance cost reduction.

While this potential symmetry is conceptually appealing, it generally does not stack up as appropriate, and it is not something that could be easily achieved.

This issue was well researched and discussed in 'Different purposes of tax and accounting'<sup>26</sup> – first published in 2003, by former Commissioner Michael D'Ascenzo and Andrew England, which is still very relevant some 12 years after it was first published.

The general thesis of that paper is that 'comprehensive alignment seems a dim prospect given basic differences in purpose and policy, and practical realities.'

Further, it is uncertain whether it would lead to entities having greater or lesser taxable income in any given year. Further, the tax revenue outcomes are not clear, as we expect different entities would have different outcomes depending on each business's circumstances.

One of the many major problems of pursuing such a measure is that currently most businesses in Australia are not required to prepare statutory financial statements that are based on Australian Accounting Standards issued by the Australian Accounting Standards Board. Many small businesses will, in fact, produce financial information solely for tax compliance purposes.

Such an approach would also potentially represent a major change to how our tax laws operate.

Before such an option could be proposed the issues discussed in that paper should be reconsidered to see if such a change some 12 years later is now more appropriate than it was in the Review of Business Taxation era.

### **Enhancing Australian business's ability to compete**

The tax reform process should be considered first and foremost through the prism on business competitiveness, and not exclusively through a tax revenue protection/ collection prism.

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<sup>22</sup> <http://www.mfat.govt.nz/downloads/media-and-publications/Features/NZ-AUS-Joint-response-to-productivity-commission-report.pdf>

<sup>23</sup> <http://www.pc.gov.au/inquiries/completed/australia-new-zealand/report>

<sup>24</sup> Recommendation 40,  
[http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final\\_Report\\_Part\\_1/chapter\\_12.htm](http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/papers/Final_Report_Part_1/chapter_12.htm)

<sup>25</sup> For example see the Review of Business Taxation, Ch.2 p20 at 2.24, <http://www.rbt.treasury.gov.au/>

<sup>26</sup> <http://www.austlii.edu.au/au/journals/JIATaxTA/2005/2.html>

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In our discussions with members as part of our process of preparing a response to the White Paper reform process a recurring theme raised has been that the Review should consider Australian business' capacity to compete with foreign owned businesses in the Australian market vis-a-vis taxes each business is ultimately required to pay.

This brings into question Australia's double tax agreements with other jurisdictions, amongst other things. One idea for consideration perhaps as part of this process is whether Australia should have a form of levy - perhaps a 'business competitiveness equalisation levy' - that foreign companies trading in Australia would be required to pay on taxable income derived in Australia - depending on the difference in the overall income tax they are required to pay in their home jurisdiction, and compared to the income tax an Australian company is required to pay on its Australian-sourced taxable income.

Such a levy might be imposed by the ACCC and not involve the ATO at all.

Of course such an idea would not be without problems, such as how to determine the levy rate per taxpayer, how to collect it, whether such a measure would breach Australia's free trade agreements and WTO rules and be seen as a form of tariff by another name, and whether other jurisdictions would 'respond' with their own 'levies' or similar.

### Simplification

In our view much of the tax simplification opportunity arises from reducing the number of taxes businesses are required to pay. If the number of taxes was reduced, this of itself would make a positive contribution to the simplification of our overall tax system.

Technology is continuing to address red tape and bureaucracy. But we must be careful that it does not add to the complexity by seeking even more information from taxpayers than what they collect through their natural systems.

As mentioned earlier in the submission (see our discussion on a single tax rate for business income) we believe that many of the complexities in the current system can be addressed by moving the tax system to a regime where business income is taxed on the same basis regardless of the legal entity through which the business is operated. Such an outcome should also provide trading entities with the option of accumulating after-tax profits which can be re-invested into working capital to improve their productivity and capacity to grow.

The areas of tax law we believe are the most significant drivers of tax law compliance for SMEs are:

- Private company loan rules - Division 7A
- Trusts
- Trust losses
- The \$6 million maximum net asset value test for accessing the small business CGT concession
- Personal Services Income
- The definition of small business entity

### The interaction between the tax and transfer system

As a general proposition, we recommend the removal of all welfare benefits from the tax system and channel such payments through the social security system via Centrelink to the extent possible.

Using the tax system to deliver welfare outcomes through for example, exemptions adds complexity to the tax system, and is considered by many to not be the best approach to addressing any identified inequity.

The design of the tax-transfer system should endeavour to minimise distortionary effects on behaviour, including workforce participation, rates of saving, and engagement in entrepreneurial and commercial activities.

CPA Australia considers that the major problem is the complexity of Australia's transfer system due to the wide range of benefits available and the nature of their interaction with the tax system including the provision of 'welfare' type benefits through the tax system and the high effective marginal tax rates (EMTRs) applicable to many transfer recipients. We also remain concerned over the use of the tax system for purposes other than raising revenue such as to pursue social policy, industry assistance and/or environmental objectives.

## Work related expense deductions

While moving to a standard deduction for work-related expense deductions would significantly simplify the tax system, it may also mean that many taxpayers, for example trades-people would be worse off as the quantum of their work-related expense claim may be well in excess of the standard deduction.

Any move to a standard deduction type system would still need to enable workers to claim above the amount subject to substantiation – similar to our current system.

## Taxation of Not for Profits

We broadly support the current income tax exemptions available for charities, PBIs and other relevant NFP organisations (public hospitals, etc) and the GST concessions, but note that there appears to be scope for some reforms in this area such as in the FBT area, the commercial activities of some NFPs and in respect to the treatment of donations.

The current FBT exemptions appear to be overly complex and generate high compliance costs which may be passed on to the intended beneficiaries in some cases. It may be more efficient, therefore, to replace the current exemptions with direct financial assistance to the relevant bodies.

It is not entirely clear that tax system complexity would be further reduced by replacing deductible donations with matched government funding arrangements for existing DGAs as there may also be some additional complexity for these bodies associated with the alternative option.