

# **BUSINESS COALITION FOR TAX REFORM**

## **TAX FORUM POSITION PAPER**

**September 2011**

### **Introduction**

The Business Coalition for Tax Reform (BCTR) is a forum of Australia's leading industry associations that brings together the views of the business community on tax reform issues (see Attachment A for a list of BCTR members).

The BCTR welcomes the opportunity to participate in the Australian Government Tax Forum (Tax Forum) on October 4-5, 2011.

The Australian public is regularly presented with tax reform proposals from government, business and the community. Yet few of these proposals make it to final implementation.

History has shown that a key element to successful – and acceptable – tax reform in Australia is active debate, discussion and community participation.

The BCTR supports a successful Tax Forum as it is likely to be a pre-requisite to acceptance and implementation of a number of the recommendations of the *Australia's Future Tax System* Review (the Henry Review).

This paper outlines the BCTR's priorities for discussion at the Tax Forum and future directions for tax reform. These are:

- principles and approach to future tax reform;
- priorities for future tax reform; and
- establishing a broad community consensus on the process for future tax reform.

### **1 Tax reform principles**

The BCTR has a long established set of principles for tax reform (see Attachment B). These principles outline a vision for Australia's tax system that is simple, transparent, promotes competitiveness, productivity and workforce participation and balances economic efficiency with equity and fairness.

While these are enduring tax reform principles, the BCTR recognises that tax reform must also be cognisant of the future social and economic challenges facing the community at any point in time.

The Tax Forum will take place against the backdrop of the following future challenges:

- the Australian Government's commitment to return the budget to surplus in 2012-13, against a background of continued uncertainty in the international economy;
- demographic change that will significantly impact government finances, both in relation to the costs of an ageing population and the capacity of government to finance those costs. Thus, a sustainable revenue base to fund essential government services associated with income support, housing and aged care/disability is important;
- a federal structure in Australia that may not be well suited to meeting these revenue and expenditure challenges, given the current allocation of spending and revenue responsibilities between the federal and state governments; and
- an increasingly interconnected and more mobile international community, which will require economies to remain internationally competitive to support living standards and wellbeing.

Successful implementation of tax reform to respond to these challenges will require building a broad community consensus on both the directions for tax reform and the approach to implementing future reforms. This will entail an acceptance by different groups in our community to accept trade-offs to allow long term tax reform to succeed.

## **2 Directions and approaches to future tax reforms**

### **2.1 A direction for future tax reform**

The BCTR broadly supports the Henry Review reforms that promote efficient, broad taxes with low rates ("Henry Review recommendations"), as the roadmap for future tax reform.

The Henry Review was established to present a blueprint for a future Australian tax system against future social, economic and demographic challenges.

The Henry Review recommendations are based on discussions with leading tax experts, both in Australia and internationally and has presented the first fully national approach to tax reform in 25 years.

Given the dispassionate and long term focus of the Henry Review, the BCTR believes that it would be a missed opportunity not to assess the Henry Review recommendations in an equally dispassionate way, consistent with the long term national interest.

However, the BCTR also acknowledges that the Henry Review recommendations do not provide all the answers for Australia's future tax system. A taxation review that is prohibited by its terms of reference from the examination of certain taxes, particularly goods and services tax (GST), is necessarily constrained in designing the most appropriate tax system for Australia's future. Therefore, tax reform must include all elements of a tax system.

## 2.2 Approach to future tax reform

Enduring tax reform will require broad community support. Tax reform is complex and affects different segments of the Australian community in different ways. The BCTR supports an approach to implementation of future tax reform that recognises:

- tax reform is a long term goal to be implemented over a 10 year horizon
  - a long term horizon will ensure tax reform proposals are assessed as enduring economic reforms in the national interest, rather than immediate responses to address short term political or budgetary interests;
  - a long term horizon also ensures a community consensus can be built around specific tax reform proposals and the scheduling of proposals to minimise disruption to the economy and the community;
- the government has a commitment to return the federal budget to surplus by 2012-13
  - implementation of major tax reforms will involve trade-offs to achieve community consensus and to maintain a responsible fiscal policy in view of the looming funding issues associated with an ageing population;
- the need for a specific tax reform process – separate from day to day tax policy functions – to be responsible for advising government and the parliament on scheduling and implementation of future tax reform. This is examined in section 4 of this paper.

## 3 Tax reform priorities

As outlined above, implementing the Henry Review's recommendations will take time and will involve trade-offs between the differing priorities and perspectives within the community.

However, before trade-offs can occur, priorities need to be set.

For the BCTR, a key finding of the Henry Review is the need for a tax system that will support strong economic growth, which will be an important contributor to filling the revenue gap that will arise from demographic changes and the forces of international competition.

In discussing the various objectives of Australia's future tax system, the Henry Review states that<sup>1</sup>:

*Australia should configure its tax and transfer architecture to promote stronger economic growth through participation and productivity.*

Accordingly, the BCTR considers a priority of future tax reform should be recommendations that are closely aligned to achievement of this tax reform objective. This includes the Henry Review recommendations that support:

- productivity, workforce participation, saving and a competitive economy attractive to business investment; and

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<sup>1</sup> Australian Government, 2010, *Australia's Future Tax System Review*, pxviii.

- the replacement of inefficient, narrow based taxes that can distort investment decisions with broad based efficient taxes conducive to efficient business investment.

Specifically, the BCTR considers a priority for further consideration of the Henry Review should be those recommendations relating to:

- the removal of disincentives to workforce participation, through reforms to the personal tax and transfer systems;
- streamlining existing state taxes to reduce compliance, and administrative costs, broaden bases and reduce the tax rates;
- ensuring Australia remains an attractive destination for international capital, by maintaining a competitive corporate tax rate and base; and
- the replacement of inefficient state taxes with a suite of broad based taxes with low tax rates.

### **3.1 Personal tax reform**

The BCTR supports a much simpler and transparent personal tax system, encompassing a high tax free threshold and simplified rates structure as recommended by the Henry Review. A reform along these lines would be expected to have positive effects on workforce incentives through:

- income being taxed, over a broader range of income, at the same rate – removing disincentives to greater workforce participation;
- a simpler personal tax scale under which the tax implications of work are more transparent, thereby encouraging participation in the workforce; and
- the incorporation of existing tax offsets into a higher tax free threshold, reducing or eliminating disincentives to work, particularly for low income earners.

As noted in the Henry Review, this approach would increase the attractiveness of work to low-income earners (including secondary earners) who are typically more responsive to effective tax rates.

Combined with these reforms, the BCTR would also support further reforms of the taxation of savings to encourage both workforce participation and savings.

The BCTR supports these reforms being developed on a revenue neutral basis, through examination of existing concessions in the personal taxation system, as outlined in the Henry Review.

The BCTR supports reforms that focus on simplifying the tax compliance and collection costs of a number of tax bases. For example, the BCTR considers the existing fringe benefits tax regime would benefit from a tax compliance simplification review as a precursor to exploring the tax reform option of taxing fringe benefits in the hands of employees.

The BCTR further supports exploring whether structural weaknesses exist within our current retirement income policy settings given the perceived lack of financial products directed towards mitigating against longevity and disability risk.

### 3.2 Corporate tax reform

A key finding of the Henry Review is that Australia's future tax system should be based on four robust tax bases, including<sup>2</sup>:

*business income, with more growth-oriented rates and base.*

The economic growth that will be required for Australia to generate future tax revenues will depend in part on continued robust productivity growth, supported by future business investment. The Henry Review notes that investment is, 'particularly supported by lower company income tax rates'.<sup>3</sup>

The BCTR supports a corporate tax rate in Australia that will encourage business investment and economic growth.

While Australia is currently the recipient of significant levels of overseas investment, this investment is being directed into particular sectors. Other sectors of the economy are adversely affected by this investment through an appreciation in the exchange rate.

The competitiveness of Australia's corporate tax rate should be reviewed on a regular basis, in comparison with our competitors for international capital and against other changes to the corporate tax base.

Australia must maintain a competitive corporate tax burden and this should be a key focus of future tax reforms.

As outlined above, the BCTR acknowledges that given current and future constraints on government budgets, changes to the corporate tax rate that come at a cost to the budget will require trade-offs elsewhere in the corporate tax system, to the extent that any revenue shortfall is not met by dynamic efficiency gains across the economy. The BCTR supports a review of existing business tax concessions to assess what options might be available to fund further corporate tax rate reductions in the medium term.

The BCTR notes business tax reform options that have been contemplated include allowing businesses a tax deduction for equity financing and various forms of cash flow taxation.

Consistent with the recognition that tax reform is an evolving process, responding to changing future circumstances, these reform options may well have greater prominence longer term and any international developments associated with the implementation of such major structural reforms should be monitored.

In the medium term, however, the BCTR considers the existing dividend imputation system is structurally sound, tried and tested and will continue to support a growth oriented focus.

A less radical business tax reform option considered by the Henry Review was a more generous tax loss regime (e.g. loss carry backs) in order to mitigate the disincentives for undertaking entrepreneurial activity.

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<sup>2</sup> Australian Government, 2010, *Australia's Future Tax System Review*, pxvii.

<sup>3</sup> Australian Government, 2010, *Australia's Future Tax System Review*, pxviii.

The BCTR supports further analysis of this reform but notes this as an example where trade-offs become an important part of any implementation analysis. Based on the initial costings prepared for the Henry Review<sup>4</sup> in respect of a modest loss carry back regime, the adverse budget impacts in the early years was sizable (approximately \$1,340M). Thus, any implementation analysis would need to consider whether the benefits of such a regime substantially outweigh the loss of other concessions to fund this reform, and the opportunity cost of pursuing an even lower headline company tax rate in the absence of a more generous tax loss regime.

### 3.3 State taxes

The BCTR supports the government's initiative to prioritise further state tax reform following the Henry Tax Review. The BCTR recommends replacing inefficient state business taxes with a suite of broad based, efficient taxes with low tax rates.

The BCTR sees the need for a long-term tax reform program that delivers dividends against milestones, which is driven by a special purpose champion, based on a National Competition Policy model.

#### Abolish inefficient State taxes

Australia is weighed down by an inefficient and overly complex tax system.

State governments are over-reliant on inefficient taxes that reduce national competitiveness, productivity improvements and the enhanced well-being of citizens. Property taxes are among the most inefficient state taxes.

The Henry Review, multiple Treasury briefing books, Productivity Commission reports and private sector-commissioned research prove that inefficient state taxes require reform. Replacing inefficient state taxes with superior revenue sources is a crucial step toward improving Australia's national prosperity.

Inefficient state taxes are:

- volatile and unpredictable revenue sources;
- difficult and costly to manage;
- deadweight taxes that impede competitiveness and productivity improvements;
- unequally and unfairly applied; and
- inhibit the enhancement of social capital.

Previous research by the BCTR analysed the impact of inefficient state taxes and concludes that the Australian community as a whole, including business, is substantially better off with more efficient taxes.

It is vital to replace inefficient taxes with efficient broad-based taxes. The BCTR has commissioned independent research to look at an optimal tax mix package to replace inefficient state taxes. This research will be provided to the Tax Forum shortly.

The BCTR recommends Government should:

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<sup>4</sup> Treasury costing minute – AFTS Proposal – loss carry back for companies 16 November 2009 [material release by the Australian Government on 28 October 2010 relating to the Henry Review costings and working papers]

- remove small, nuisance taxes, such as fire services levies;
- streamline existing state taxes to reduce compliance and administrative costs, including base-broadening measures, removing inequitable aggregation arrangements, adopting consistent methodologies and implementing online electronic compliance systems; and
- implement longer-term structural tax reforms underpinned by an inter-governmental agreement to remove inefficient state taxes and end state over-reliance on property taxes.

However, Australia also needs to invest in long-term reform programs that comprehensively rationalise inefficient taxes that reduce prosperity.

The BCTR's other recommendations can be financed by replacing inefficient and unfair taxes with a suite of broad based taxes that encourage economic efficiency and better spread tax burdens. Independent research indicates this will:

- increase GDP and investment;
- enhance economic activity that translates into higher federal (and state/territory) government tax income;
- increase productivity; and
- reduce reliance on volatile tax bases.

#### **4 The process for implementing tax reform**

A considerable investment has already been made by government and the community in the development of the Henry Review recommendations.

The commitment to this investment reflects the expectations of the Henry Review as a long term blueprint for reform, that would transcend the immediate day to day demands on any particular government for discrete changes to tax and transfer policy.

The Henry Review has undertaken an objective assessment of the challenges in filling the revenue gap that will face Australian governments, federal and state irrespective of their political persuasion.

Similarly, there is a considerable desire within the business community for the implementation of the Henry Review reforms to be undertaken through an equally dispassionate and considered process, separate from the short term pressures applied to both government and the community for changes to the tax and transfer systems.

The BCTR strongly supports a process for implementation of tax reform incorporating the Henry Review recommendations as a base. This process should have input from all levels of government but be separate from day to day management of the tax and transfer systems.

This process should have the following features:

- a specific independent tax reform review board established by the government, separate from existing policy, administration and oversight agencies, with an independent Chairperson and a mandate to progress tax reform using the Henry Review as a base;

- the tax reform review board would have an advisory role, to advise the government and the parliament on specific reform recommendations and the scheduling for implementation;
- the tax reform review board would consult widely with the community on the priorities and scheduling of future tax and transfer reforms;
- the tax reform review board would prepare a detailed, thorough analysis of proposed reforms;
- the tax reform review board would include on it representatives from government (and ideally include state/territory and local government representatives), business and community organisations;
- the tax reform review board would develop an intergovernmental agreement that identifies short, medium and long term goals including a timetable, transitional measures and compensation mechanisms;
- the tax reform review board would need to be resourced by government to fulfil its mandate; and
- the tax reform review board would develop transitional arrangements that reflect an understanding of the impact of reform on all stakeholders.

The purpose of the implementation agency would be to ensure that implementation of the Henry Review recommendations and any other reforms identified in the government's October Tax Forum, are based on advice separate to that received on a day to day basis by governments from its existing policy and advisory agencies.

The rationale for this approach is that:

- being a long term blue print for tax and transfer reform within a Federated system, the Henry Review recommendations should be considered on their own merits, separate from the immediate pressures on government;
- a tax reform review board can advise on the implementation of reforms in a structured way, over a longer time horizon than the normal political cycle;
- by presenting a staged series of reforms over a longer period, the tax reform review board would be able to present a timetable for long term reform that has broad community acceptance; and
- the combination of long term structured reform recommendations that are developed separate to day to day management of the tax and transfer systems and with broad community acceptance, is more likely to attract bipartisan support.



## **BUSINESS COALITION FOR TAX REFORM**

### **Members**

Australian Financial Markets Association

Australian Industry Group

Australian Institute of Company Directors

Business Council of Australia

Corporate Tax Association of Australia

CPA Australia

Council of Small Business Organisations of Australia

Financial Services Council Limited

Group of 100

Insurance Council of Australia

Minerals Council of Australia

National Institute of Accountants

Property Council of Australia

Real Estate Institute of Australia

## BUSINESS COALITION FOR TAX REFORM

### TAX REFORM PRINCIPLES

1. The tax system should be simple, transparent and should minimise uncertainty.
2. The design, administration and operation of the tax system should be undertaken with full and effective consultation with relevant stakeholders including the business community.
3. The tax system should fairly balance the need to protect the taxation revenue base with the principles of a good tax system, i.e. efficiency, fairness (horizontal and vertical equity), simplicity, clarity, certainty and low compliance costs.
4. The tax system should enhance competitiveness by providing a climate conducive to improved investment in Australia and from Australia for Australian-based entities and individuals.
5. Indirect taxation at the state and territory level should be more efficient and competitive.
6. The pattern of Federal/State financial relations should be transparent, efficient and sustainable.
7. The tax treatment for savings should be consistent with an overall savings policy that encourages the sustainability of strong, ongoing growth.
8. The tax, and social security, treatment of personal income and fringe benefits should conform to the principles of fairness, efficiency and simplicity.
9. The tax system should avoid the double taxation of business income and provide relief for all business expenses.
10. The tax system should not impede organisational restructuring.