TAX FORUM 4-5 OCTOBER, 2011 **APPENDIX 1**

STATEMENT OF REFORM PRIORITIES

ADDITIONAL INFORMATION

MACRO REFORMS

1. **Separation of the taxation function from the political system is essential**

   On every change of government, there is a change to the taxation system, whether it be the introduction of a new tax, the change to tax rates, rebates or tax offsets, changes to the definition of adjusted taxable income, assessable income or some other new descriptive term that limits or extends other government benefits. Continual change limits certainly, and encourages 'spikes' in consumption where tax concessions are available for only a short period of time (sometimes until the next election).

   The design of the taxation system should be based on long term principles of ensuring collections are sufficient to meet the short and long term financial needs of the country, including taking care of the sectors of the community that need financial support and assistance. This should not be considered on a 3 year term basis.

   All changes to the taxation system should be reviewed in the light of good governance principles, rather than for the benefit of any one political party over another – there should be no political interference in the taxation system.

   The independence of the Reserve Bank is an example of how major economic decisions can be made, separate from the government of the day. I see the overseeing Taxation Board operating as a Board of Directors, steering Australia's taxation system through short term fluctuations, while always measuring results against the long term plan. Legislation in relation to change will still be tabled in Parliament after robust review by the Board and their advisors, but will not be tainted as having been put forward by one political party or another.

2. **The principals of good corporate governance should be applied to all decisions to make changes to the taxation system**

   The Australian Institute of Company Directors produces the 'Guide for Directors and Boards – delivering good corporate governance' – in less than 20 pages, it describes the 10 principles and guidance required as part of the professional development of directors and boards. All of these principles are applicable to the reform of the taxation system, specifically from the perspective of the individuals involved in the process, but some principles also apply to the resulting reforms that are recommended.

Principles such as integrity, enterprise, fairness, accountability and transparency are all terms that can be applied directly to legislation enacted in relation to the taxation system. Where these are applied to decisions in relation to change, all parties should be confident that the change is in the interests of the country as a whole.

3. **All proposed changes to the taxation system should be based on a long term measure of increased productivity and prosperity for the country, in addition to the essential items of increased economic stability and certainty for all participants**

   The taxation system needs to provide sufficient revenue to meet the short and long term funding commitments of the government. The more stable the economy, the more certain the income stream for government plans and projections to be based on. Certainty is not only positive for the government, but for the business and general taxpayer community, who can then make short and long term spending decisions, confident that there will be no change in the taxation system that would adversely impact these decisions.

   Taxation change should encourage, and not hinder, increased productivity and resulting prosperity. Changes to the tax free threshold and unrelated but associated Centrelink changes that allow recipients to earn more from working, while still retaining a level of benefits, and without incurring a tax liability in the process, provide incentives that should be further explored. As the population ages and more people retire, there is a huge pool of expertise that needs to be encouraged to continue to participate in work, without incurring a financial or taxation penalty for doing so. The passing of this knowledge (and work ethic) to the next generation is essential to ensure the future growth of the nation. These challenges are with us today.

4. **Limit taxation collection to annual taxation returns or monthly/quarterly/annual Business and Instalment Activity Statements (BAS and IAS)**

   Business does not need another method of collecting taxation revenue, in addition to the systems that are currently operating – if the collection can't be made through the existing means, I think that any new tax should be reconsidered.

   After 11 years, the monthly, quarterly or annual BAS/IAS collects and credits GST and a number of other taxes, including Wine Equalisation tax, Luxury Car Tax (I would question the benefits of both of these taxes), Fringe Benefits tax, Pay As You Go Withholding and Instalments, fuel tax credits etc. If any additional tax is to be imposed, it should be made part of this process, rather than an additional, separate form for business to complete on a regular basis.

   Similarly, changes to income tax should all be embodied within the income tax return (regardless of the entity) rather than the requirement to complete and extra form or lodge an additional document.

The taxation system relies on all individuals and entities to meet their compliance obligations , and this can take a considerable amount of time. The government has the benefit of having a collection system (us) that is extremely cost effective, and as a result the individual and business community has an expectation that the government will minimize it's costs in relation to the processing of data – the taxation office should not need to set up additional administrations to cater for new/changes to taxation.

5. States must remove growth stifling taxes, such as Payroll tax and Transfer (Stamp) Duty, in exchange for a greater portion of federal revenue

As someone who can remember the commencement of GST on 1 July, 2000, I can clearly recall the declaration that a number of state taxes were to be phased out over the first five years of the operation of the GST – this was part of the incentive for the community to vote in this new tax.

Unfortunately, the removal of these taxes (stamp duty on insurance and hiring, stamp duty on share transactions etc) occurred over an extended period of time and to only a small number of state taxes - we are still left with those that impede investment, pit one state against another in securing business investment and impose an unreasonable cost on many small businesses.

Payroll tax penalizes employers for increasing the size of their workforce, even though this is the key to reducing unemployment, which is a government objective. Employers are not only responsible for many mandatory employee related costs, such as superannuation guarantee and Workcover, they also invest in their employees through training and education to provide the best possible service or product to their customers/clients. Apart from being a revenue raising exercise, I am unaware of any benefit provided to the business or general community as a result of this tax.

Transfer (stamp) duty is an up-front penalty for those prepared to take the risk in acquiring assets.

Where a residential investment property is purchased, rental accommodation is provided, which assists the government in that less public housing places need to be made available. Where commercial premises are acquired, a risk is either being taken to find a tenant for these premises ,or by the business owner who is going to operate his/her business from them. Where a business changes hands, the new owner is taking a considerable risk that they can emulate (at a minimum) the results of the previous owner.

The economy needs those who are prepared to take risks, as they provide benefits to the balance of the community, in the forms of employment, education, training etc. Penalties applied in the form of state taxes need to be reviewed and removed, to provide incentive and certainty to the business and investment community.

6. **The taxation system needs to provide a long term, continual stimulus to the economy, not create positive or negative activity spikes for individual sectors**

   Where taxation reform and change is linked to individual governments, we see short term stimulus policies imposed to provide the desired results, for example, the tax break legislation which encouraged the acquisition of capital items, over a short period of time. At the end of the stimulus, industry turnover drops until another government incentive is provided. A similar impact was felt in the real estate industry with the expansion and contraction of the first home owners grant. This boom and bust mentality hinders long term business growth, as there is short term expansion in the boom times, but then immediate contraction in the bust times. This creates a great deal of uncertainty for the business and wider community.

   Secure, long term employment throughout their working lives is the goal of many individuals. This security, in itself, will stimulate the economy through consistent spending.

   Where stimulus to an economy through taxation measures is to be adopted, it should ideally be over a long time period, and be in the form of permanent change. An example of this is a permanent, accelerated change to the depreciation rates for the acquisition of capital assets, which would provide incentive and certainty, as well as benefiting a wide range of industries.

7. **The taxation system should encourage business investment, but only to the extent that future returns exceed capital introduced**

   There have been some recent comments in the press about the benefits of business having equity, rather than debt, finance, and whether there should be taxation concessions associated with these investments. Over the past three years, since the commencement of the GFC, we have seen retirement savings decimated due to the failure of a large number of agricultural based, and other, financial investments. While it was advantageous for the companies involved to seek equity, rather than debt, finance for their expansion, their often unsophisticated and disparate investors were in a much weaker position to obtain information on their progress than a bank would have been, resulting in a significant loss of resources.

   Where taxation concessions are provided, they must be on the basis that revenue will be generated in excess of the investment made – often, the most effective way to 'match' the expenditure with the revenue is for it to be claimed over a number of years by instalments, so that (ideally) revenue will be generated over the same time frame.

   The taxation system should also recognize different types of equity investments, and give investors the option of claiming their cost base on the eventual disposal of the asset, rather than at an earlier point in time.

8. **Cease to think of tax as something to be collected and the later repaid to taxpayers, either as a cash refund or as increased deductions at a later time**

   It seems illogical that the government collects taxation revenue, only to repay that specific revenue to the community over time – not just to those who need it, but to specific classes of taxpayers. Such is the case with company imputation credits.

   While it is not up to any government or taxation official to tell individuals how to arrange their taxation affairs, the considerable benefits to be obtained through the refund of imputation credits, specifically by low income individuals and superannuation funds, has certainly assisted the flow of funds through, and subsequent growth of, the economy.

   Less revenue needs to be collected where less is subsequently repaid.

   Having a lower company tax rate would make Australian companies more competitive and Australia a more favorable destination for business, especially considering the relative political stability of the nation. Less tax can also lead to a higher level of dividend cash payments for investors.

   Another example of taxation collected, where the benefit is repaid over time, are the anti-detriment superannuation payments, which are effectively a refund of the contributions tax paid by the deceased member during their lifetime. This additional amount is then paid to the spouse, former spouse or child of the deceased. While this benefit is technically available to everyone, the superannuation fund must structure it's affairs in a way that allows this additional payment to be made. Often, self managed superannuation funds are unable to take advantage of this concession, as the total of their net assets are vested in their individual member accounts, with no surplus to make the additional payment.

   Why collect the contributions tax to then repay it on the death of a member?

   There should not be an expectation in the community that the government will give tax money collected back to the community, unless there is a real need, such in the case of natural disaster payments. Where there is a separation between government and taxation policy, there will be more consideration of the long term implication of all taxation collection and payment policies, with the view to collect less in the first place

9. **Goods and Services Tax, after 10 years in operation, needs to be reviewed for effectiveness, not necessarily to increase the rate of GST, but to review the exemptions and carve outs**

   The government has made it abundantly clear that the GST is outside the scope if the review, as it was with the Henry Review. It is unusual to consider that a major mechanism of taxation collection not be discussed as part of any tax reform agenda.

If the government is averse to increasing the rate of GST so that the states can remove taxes such as payroll tax and transfer (stamp) duty, it should review the GST free and input taxed items to ensure that it is still appropriate that no GST at any rate be paid on these transactions.

Considering the increase in the volume of financial transactions over the past 11 years, it may be appropriate to change the rate of GST imposed on input taxed transactions from zero to a nominal percentage – this would not impose a significant burden on other input taxed supplies, such as residential housing, but would collect a significant amount of revenue from the financial services sector. This revenue could be collected in a similar manner as applied to stamp duty previously imposed.

It may also be timely to review the range of GST free items to ensure that it is still appropriate for these goods and services to be free of GST.

10. Taxation must be given the resources to continually update the legislation, review for improvements that can be made and to limit the regular need for review as imposed by the government

The ITAA 1936 is still in the process of being rewritten into the ITAA1997 – 14 years after commencement. There is a vast pool of taxation professionals who can assist Treasury with this process. It is essential that 'old heads' are involved in this exercise, as they have the depth of experience required to identify the implications of any change to the legislation to other elements of the same legislation , or to unrelated legislation. The transitional provisions that relate to the streaming of dividends and capital gains in trust distributions is the perfect example of a simple idea being made into a complex exercise as a result of the legislation. We need some practical application in the review of all legislation to ensure that the cost of tax compliance does not outweigh the benefit itself.

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STATEMENT OF REFORM PRIORITIES

ADDITIONAL INFORMATION

MICRO REFORMS

Small Business Taxation Reform

Small Business concessions provide a number of benefits, including simplify accounting for transactions, taxation concessions and generous depreciation provisions.

Many small business people who have taken the risks associated with operating a business have been rewarded on eventual sale with a nominal tax liability (if any) on meeting the requirements of the small business concessions. Similarly, there are also many genuine 'Mum and Dad' small businesses who have found their turnover or net assets 'just before the CGT event' in excess of the relevant threshold, and are not able to avail themselves of these generous concessions.

These concessions can be seen to be an automatic way to stimulate the economy, through the regular replacement of capital items, which are subject to accelerated depreciation. If they were available to a larger pool of businesses, there would be less need for direct government stimulus measures in this area.

The key to all of the above is twofold:

1. Having a stable tax system, where concessions are available indefinitely, so that business owners can plan for the tax implications of the growth of their businesses, and their eventual retirement;
2. Having a stable government that does not regularly change the goals posts for business and households – spending will only occur where people are confident that their positions are secure. This confidence and security will only occur in a stable economy.

The definition of a small business entity in section 328-110 of ITAA 1997 is limited to businesses with turnover of less than $2m – this is inadequate, and contrary to the government's own measure of small business. The ATO Small and Medium Enterprise Working Group is concerned with entities whose turnover is between $2m - $250m. The small business car parking fringe benefit exemption applies to businesses which would otherwise be required to pay FBT on employee parking, except that their turnover does not exceed $10m. Recommendation 30 of the Henry Review recommended the threshold be increased to $5m and that there be increases to the $6m net asset test.

The 2011/2012 budget measures that impact small businesses include the immediate write off of assets purchased with a cost of $6,500 or less from 1 July 2012, immediate write off of the first $5,000 of the cost of a motor vehicle (as accelerated depreciation) and a change to a 29% company tax rate for the 2012/13 financial year.

Considering the current state of the economy, the change in the company tax rate is likely to provide little relief in the short term, as losses are incurred and later consumed. This legislation is also dependent upon the passing on the Mineral Resource Rent Tax 2011 legislation, which is due to commence on 1 July, 2012. I understand that this legislation is to be put to the house before the end of this calendar year, creating much uncertainty as to whether the small business concession as outlined will be in place for the 2012/13 year.

Specific Recommendations:

- $5m GST exclusive turnover test for small business concessions – both revenue and CGT concessions
- Immediate write off in relation to assets costing $6,500 or less (this could have been limited to $2,000 - $5,000 and applied to all businesses)
- Small business write off all other assets (except those with an effective life of 40 years) at the rate of 25% in the year of acquisition and 25% in each of the following 3 years (currently the rate is 15% in the year of acquisition with 30% diminishing value for the balance – this leaves a 'tail' in the written down value of the asset. Prime cost is a simpler and cleaner method of dealing with depreciation). This would also remove the need for government to provide extra concessions in relation to the purchase of vehicles, due to the 25% immediate concession and total 4 year write off.
- Leasehold improvements should be written off over 4 years, or the term of the lease if this is shorter (excluding month to month leases)
- $6m net asset test should be indexed or preferably increased to $10m as a flat rate for the next 5 years and thereafter reviewed, in line with the turnover test being increased.
- Treat the 50% active asset concession in a similar manner to the 15 year concession for companies, in that the capital gain on disposal of a small business is treated as non assessable, non exempt income and if paid out to a CGT Concession Stakeholder (in the same proportion as described in s152-125 (2) ITAA 1997) within 2 years of the CGT event, this amount will not be assessable income in the hands of the CGT Concession Stakeholder.
- Allow individuals who originally structured as a sole trader or partnership, or where a business is operated by a trust, is 'rolled' into a company under Subdivision 122A and 122B of the ITAA 1997, to start the clock ticking from the date of commencement of the business, not the date the business was rolled into the company, when considering whether the 15 year concession is available.
- As an alternative to the 'Significant Individual' requirement in s152-110(1)(c), allow discretionary trusts that are 'Family Trusts' (where a Family Trust Election has been completed) at the time of the CGT event, and where all other conditions are satisfied, to access the 15 year concession. It may be appropriate to review whether the 'significant individual' concession should be required to access the 15 year concession for any entity – the business having operated for 15 years could be a key measure.

- Need to be able to index the $500,000 lifetime limit under the CGT Small Business Retirement Concession for at least CPI annually. Recommend that the lifetime limit be increased to equal the CGT 15 year concession (currently $1,155,000). This measure will assist small business owners to fund their retirement, independent of government assistance.

Superannuation

Much reform is currently being undertaken in relation to superannuation. The significant issues that I would like to address are twofold:

1. Individuals with significant superannuation pension assets may be making little or no contribution to the tax base, but are still consuming federally and state government funded services, and ;
2. As a result of the changes to the superannuation borrowing rules, more self managed funds are acquiring property directly as part of their investment strategy. When a member dies, apart from where reversionary or other pensions can be put in place for a surviving spouse or qualifying dependent, the property must be sold or transferred in specie so that death benefits can be paid out of the fund. This is a costly and non productive exercise – legal costs and commission may be payable by the fund and stamp duty is payable where a related party acquires the property (specifically where the property houses a related party business). The restricted time frames imposed on superannuation funds in relation to the payment of death benefits may also adversely impact the sale price achieved.

Superannuation, while being solely for the provision of retirement benefits for members, can have an indirect, intergenerational benefit when a member suffers an early demise. Also, considering that many members are working past age 65 and continuing to contribute to their superannuation funds, the minimum pension percentage to be drawn from member balances each year may be insufficient to have all of the funds paid out to the member prior to their death.

If assets were able to be retained in a superannuation fund, this would have a long term benefit for the government, continuing to collect tax where assets are held in a 'safe' environment, not subject to dissipation by beneficiaries who become bankrupt, are parties to a family court proceeding or simply where assets are wasted over time. Considering superannuation funds are audited each year, there is a high level of supervision of these assets.

The attached draft notes discuss the two superannuation proposals to be introduced at the same time – having an interest in superannuation from an administration view point, but not being a superannuation specialist, I request these notes be reviewed on that basis.

Considering the sensitive issue of imposing tax on member's pension assets, I think that it is essential to also give members an option of their death benefit being able to be retained in a superannuation environment – this could be seen as a considerable advantage by some to offset the negative implications of paying tax on superannuation pension benefits.