Australian Government

A tax plan for our future
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# TAX FORUM 4-5 October 2011

## STATEMENT OF REFORM PRIORITIES

### PARTICIPANT NAME AND POSITION

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### ORGANISATION

Corporate Tax Association of Australia

### STATEMENT OF PRIORITIES

Around two or three pages, please. Please address both of these issues:

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

The order in which the following items are set out do not necessarily reflect the relative importance of the respective issues. Each of the issues raised is an important and integrated element of an improved tax system that will deliver productivity gains and improve the wellbeing of all Australians.

1.1. The tax system needs to generate sufficient revenue to fund government expenditure (at all levels) over the long-term.

1.2. However, government expenditure should be subject to independent review for program efficiency and effectiveness.

1.3. Inefficient State taxes should be either abolished or improved. Recent research has consistently shown that replacing inefficient State taxes with other more efficient taxes and improving the design of remaining State taxes would lead to improved economic growth. A significant proportion of that incremental GDP flows to governments as additional revenue. Some specific ideas on State taxes are as follows:

**1.3.1. Insurance taxes and fire levies should be abolished.**

Insurance taxes and emergency services levies involve a high average economic burden[1] and contribute to under insurance on the part of some households[2]. If emergency services levies are thought to be desirable they should be imposed directly on all property owners – not just those who purchase insurance cover.

[1] KPMG econtech, September 2011
[2] AFTS Recommendation 79, May 2010

**1.3.2. Stamp duties on conveyancing should be abolished.**

Both commercial and residential conveyancing stamp duties carry a high average economic burden[3]. By increasing the capital cost of property these duties discourage business from investing in or improving property, while discouraging households from relocating for employment reasons or to move to more appropriate accommodation. They also contribute to the housing affordability problem.

**1.3.3. Motor vehicle registration fees and stamp duties on transfer should be abolished and replaced with charges based on road usage (including time of usage).**

Australian road users already pay high taxes, but these taxes are ill targeted and could be better designed to reflect external costs. Usage based road charges are technologically feasible and have the potential to deliver significant social and economic benefits through the improved utilisation of critical infrastructure[4]. Fuel excise charged to road users should likewise be abolished and replaced with transparent road user charges.

**1.3.4. The land tax base should be broadened and the rate reduced.**

Land tax is a relatively efficient tax in terms of its economic burden and it is also difficult to avoid. However, its base is unduly narrow, due mainly to the principal residence exemption. Land tax should be applied at a flat rate, without penalising multiple holdings – we believe this would have a positive impact on the supply of rental accommodation. Where the imposition of land tax on residential property creates hardship for some households (particularly for older Australians), a deferral arrangement could be implemented, involving some sort of equity interest by the revenue over the relevant property.

**1.3.5. The payroll tax base should be broadened and the rate reduced.**

Payroll tax in its current form (including thresholds and exemptions) almost seems intended to keep small business small. It could raise the same revenue with a significantly lower rate by extending it to all businesses. While it falls on employers in its legal form, giving it the appearance of being a tax on jobs, its incidence is regarded by many economists as falling on employees in the form of lower wages and consumers in the form of higher prices[5]. These characteristics make it more like a consumption tax which, without thresholds or exemptions, is relatively efficient, simple to collect and difficult to avoid.

[3] KPMG econtech, September 2011
[4] AFTS at E3
[5] AFTS at D3-1

A uniform broad payroll tax base (including in respect of exemptions and thresholds) needs be agreed by the States and should be administered on their behalf by the ATO on the same basis as the GST. States should be able to set their own rates. However, with a broader base our expectation is that the rate would be significantly lower than those currently levied by the States.

#### 1.3.6. Streamlining and harmonisation

Those State taxes that remain should be harmonised to the maximum extent possible, including, for example, the rules regarding relief for corporate reconstruction (in the absence of the abolition of stamp duties).

### 1.4. Australia's overall tax mix needs to be revisited, including the GST.

Our current reliance on taxes on income is unsustainable – particularly given the impending rise in healthcare costs (driven partly by changes in technology and partly by demographics), and the likely future cost of caring for severely disadvantaged Australians[6]. Taking these factors into account, the rates of personal income tax and company income tax needed to support those levels of expenditure would seriously compromise Australia's international competitiveness.

At 10 per cent, Australia's GST rate is low by international standards. In fact, as a result of the global financial crisis a number of countries have increased their VAT rate while at the same time reducing their corporate income tax rate. The GST base in Australia is about average, although various exemptions (mainly fresh food, health, education and financial services) represent a leakage of potential revenue of well over $10 billion. They also create complexity and uncertainty for business. The AFTS report notes that GST-free food alone involves revenue foregone of $5 billion, most of which benefits higher income households[7]. The GST would be an even more efficient tax if it were levied on a broader base and at a higher rate since the cost of collection would be about the same.

There is significant scope for generating additional revenue from consumption by increasing the GST rate or broadening the base, or by doing both. And by designing an appropriate compensation package for lower income households, this outcome can be achieved without having a regressive impact on equity outcomes. Lower income households were compensated in 2000 when the GST was introduced, and just recently the government has announced that lower income households are to be compensated for the effects of a price on carbon dioxide emissions that is due to commence in 2012.

[6] Productivity Commission August 2011
[7] AFTS at D2-1

We recognise the political challenges confronting any government seeking to make the changes we believe are necessary. However, objections based on equity grounds or suggestions that it would cost more to compensate lower income households than the additional revenue raised[8] are not soundly based.

We also recognise that making a switch in the tax mix might be more realistically attempted in a more robust budget environment, where funds are available for personal tax reform, as was the case when the GST was first introduced. However, that should not be a barrier to debating these necessary reforms today.

### 1.5. Personal tax and transfers

Reducing personal tax rates would not deliver the same economic benefits as reducing a number of other taxes would, since the average excess burden is lower. However, both marginal and average rates do have an impact on work/leisure and education or training choices made by individuals and we consider it would be desirable for the government to at least recommit to the aspirational personal tax rates it took to the 2007 federal election.

The increase in the threshold announced as part of the carbon pricing package is seen as being positive in terms of encouraging individuals to participate in paid employment.

The government announced some modest changes to transfer arrangements in its 2011-12 budget, which involved means testing a number of benefits. We regard this attempt to wind back 'churning' as a positive development and would encourage the government to consider going further, including means testing some areas of expenditure, such as health and education. However, this is subject to the important proviso that major adjustments to churning should be accompanied by offsetting reductions in the personal tax burden, which is something we haven't seen as yet.

The CTA supports the AFTS recommendation that all personal income from capital should be subject to a discount, without the amount being capped (as in the case of the recent concession for income from interest). This would reflect the mobile nature of capital and remove the current tax based distortions to the choices individuals make about different forms of savings.

[8] Which would mean that higher income households would pay no additional GST

**1.6. The company tax rate should be reduced to no more than 25%**

The CTA supports the AFTS recommendation that the company tax rate should be reduced to 25 per cent in the short term. The AFTS Report concluded that in the longer term the incidence of company income tax falls significantly on labour and that reducing the rate is likely to encourage innovation and entrepreneurial activity and build a larger capital stock that will improve productivity. It should also encourage additional foreign direct investment while reducing incentives for multi-national firms to shift profits out of Australia[9]. We believe there may be some scope within the current business tax system to fund part of the net cost of such a reduction. We would be prepared to work with the government on identifying sensible funding options in the context of these and other reform measures.

Some other business tax issues include:

1.6.1. **Loss carry- backs**

Business has for many years sought the ability to carry back revenue losses on some basis. Economic cycles can 'trap' losses for many years (and in some cases permanently) after a company has paid tax in the initial years of an enterprise but has made an overall loss.

1.6.2. **Freeing up loss carry-forward rules**

Rules around continuity of ownership and carrying on the same business that were designed to prevent trafficking in tax losses are having an impact beyond their intended integrity purpose and have for many years resulted in companies being denied access to real losses legitimately incurred in the course of their business. Being denied these losses represents a systemic distortion to the tax system and the rules need to be recalibrated so that they apply in the way they were intended.

1.6.3. **Abolish interest and royalty withholding taxes**

The imposition of interest withholding tax imposes additional costs on borrowers, who are almost invariably obliged to "make good" the lender by grossing up the relevant amounts. A number of exemptions are available, which can create competitive issues or result in inefficient practices in order to qualify for an exemption. Most competitor countries do not impose interest withholding tax and having it apply, even in a limited number of cases, is inconsistent with Australia's aim of becoming a regional financial centre.

[9] AFTS, Part 2, Chapter B1-1

Royalty withholding tax likewise falls on the local customer rather than the foreign IP owner, thereby imposing additional costs on Australian business. In many cases leasing is a close substitute for borrowing, and additional withholding tax costs should be removed from both forms of finance. Both these taxes should be abolished unilaterally.

## 1.7. State/Federal relations

Increasing the GST base and rate would go some way to reducing the vertical fiscal imbalance, although not to a sufficient extent to offset the abolition of stamp duties and other State charges. Consideration should be given to giving the States access to another significant source of untied revenue in the form of a share of personal income tax.

## 1.8. Tax administration

The CTA supports the government's proposal to create a Tax System Advisory Board to provide strategic advice to the Commissioner of Taxation on the general organisation and management of the ATO, noting that such an arrangement would not in any way impinge on the statutory independence of the Commissioner. Such a board should be headed up by an independent chair and its members appointed by the government.

The suggestion that the ATO is already overly scrutinised may have some merit. Consideration should therefore be given to merging the various bodies that currently review ATO effectiveness and efficiency, including the Inspector-General of Taxation, the Tax Ombudsman and part of the ANOA. Such an agency should be adequately resourced.

In addition, the CTA makes the following two recommendations aimed at further improving some aspects of the tripartite process for the development and design of our tax laws:

### 1.8.1. **ATO endorsement of tax bills**

While the Treasury has responsibility for instructing the Office of Parliamentary Counsel on new tax legislation, the ATO (as well as external stakeholders) is generally involved in a tripartite consultation process that is aimed at ensuring the bill achieves its intended purpose, does not present any avoidable administration problems for the ATO or impose unnecessary compliance costs for the community. For the most part this process has been working well.

However, there have been instances where, sometimes after a period of some years, the ATO will form the view that the legislation does not achieve its intended purpose and may require amendment[10]. This causes uncertainty and creates significant compliance costs for taxpayers.

We consider the process could be further improved by requiring the Commissioner to warrant to the Assistant Treasurer that he is satisfied a proposed Bill is workable from his perspective and achieves its intended purpose. This is not intended to limit the way in which the ATO interprets the law once it comes into effect, but will hopefully avoid outcomes where the law is found to be defective and requires amendment at a later time.

#### 1.8.2. **ATO endorsement of explanatory material**

For broadly the same reasons, we consider the Commissioner should also warrant to the Minister that the explanatory material, including any examples used to illustrate the way the law works, conforms to its understanding of the Bill. There have been instances where the ATO has indicated it does not consider that a particular example in the explanatory material accurately reflects the law.

Although we fully understand that the law itself would generally over-ride the explanatory material where the two are in conflict, we consider it is highly desirable from a public policy point of view that the community is able to rely on any explanatory material that accompanies a Bill.

### 1.9. Arrangements for ongoing tax reform

Given the ambitious scope of the upcoming Tax Forum and the broad range of participants, it is considered unlikely that sufficient consensus will emerge over the two days to translate into policy that can be implemented. In order to maintain momentum and capture the potential gains from having a more efficient tax and transfer system, it is recommended that new institutional arrangements be put in place to take the tax reform process forward. The CTA would like to see the establishment of an independent agency that would commission research and publish position papers for community discussion and debate.

[10] For example, in relation to the application of section 974-80 of the *ITAA 1997*

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

As we have indicated first and foremost, the tax system has to be self-sustaining in the long-term, and as a nation we should not be accumulating net debt over the business cycle. The abolition of inefficient State taxes and lowering the company income tax rate would be very costly if implemented in isolation, although we have indicated there may be scope for funding some of the cost through the broader business tax system.

The various changes we have proposed are inter-connected and their impact on the budget will depend on which changes are implemented and when. Clearly, however, if there is no appetite to consider the GST or some alternative cash-flow based tax, there is little scope at the present time for significant tax reform. We appreciate the political difficulties and the genuine concerns held by some groups, but in our view the tax mix is an issue we cannot avoid addressing in the years ahead.

## LIST OF ATTACHMENTS

Feel free to attach supporting papers if you wish. Please list them here.

There are no attachments to the CTA's Statement of Tax Reform Priorities.