Australian Government

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

STATEMENT OF REFORM PRIORITIES

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Ernst & Young's global tax policy network has extensive experience of helping develop and implement policy initiatives, both as external advisers to governments and companies, and as advisers inside government. Our tax policy professionals and business modellers help address specific business environments and improve the outcome. It's how Ernst & Young makes a difference.

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STATEMENT OF PRIORITIES

This summary

- highlights some directions for potential Australian business tax reform in the short term, addressing Australian tax impediments for businesses which restructure in a changing and volatile economic environment
- identifies the importance of a strong governance process relating to tax reforms, including transparent consultation processes before governments announce significant tax reforms, and tax administration
- reconfirms the longer term reform priorities on which we have engaged in consultations previously.

Taxation reforms for consideration in the short term – to support business development and restructure in a time of change

In our view potential Australian business tax reform in the short term should address Australian tax impediments for businesses which restructure in a changing economy. Reforms are needed to improve the position of Australian businesses which are affected by changed economic conditions and, under current tax rules, suffer real adverse tax outcomes.

Put simply, Australia's tax rules are designed for businesses and taxpayers which have ongoing business activities and are able to use the stream of tax deductions which flow from their losses and outgoings. Many of the deductions are deferred to match the revenue streams anticipated.

However, where a business suffers a downturn or adverse business conditions, its revenue stream might be impaired or indeed cease, its asset values might fall, its expenses might remain high and be increased pending the business' recovery. For tax purposes:

- While some of those outgoings might be immediately deductible, others might be deferred for up to 5 years or **might never be available** until the relevant asset is sold.
- even where there are immediate tax deductions, the business might have insufficient income to fully utilise all of its tax deductions and will thus deliver a tax loss.

  So the tax benefit of losses is deferred; the business does not have the tax offset or tax benefit which a profitable business would have from immediate use of the tax deductions.

Furthermore, the business might never be able to claim its tax losses where it has a significant infusion of new capital to refinance it and changes its business activities.

The Australia's Future Tax System Review (the AFTS (Henry) Review) chaired by Dr Ken Henry identified the need to reform "tax arrangements that effectively impose an additional charge on the taxpayer, such as limitations on the use of losses..." [1]

In the attached three appendices we summarise some options for short term action to:

1. Improve the tax outcomes of restructure costs

2. Improve the outcomes of restructures under the tax loss and bad debts rules

3. Improve the competitiveness of Australia to attract business activity by reducing company tax rates, including potential examination of business expenditure tax options such as an Allowance for Corporate Equity (ACE).

Governance of the tax reform process and tax system administration

Australia's tax system needs reforms. The AFTS (Henry) Review proposed many for debate and there is not agreement with all its recommendations.

The reforms require a strong and consistent process of debate, consultation and collaboration– better governance around the tax reform process. Before government announcements of reforms

[1] AFTS (Henry) Review Report, Vol.1, page 169

are made, preliminary policy debate and analysis should develop a shared view of the need for reforms, their priority and direction. These processes are used for many reforms including reform of tax financial markets rules. The Tax Forum offers an opportunity to agree and apply them generally.

Another immediate priority is improving governance of Australia's tax administration, which needs greater certainty and efficiency. This is relevant also given the potential over time for a more unified tax administration to cover various state and federal taxes. We note that Canada has one Revenue Agency to cover federal and provincial taxes.

Longer term reform directions

We do not, in this short summary, set out the complete long-term priorities for reform which have been covered in our joint submissions to the AFTS (Henry) Review[2] and other submissions, including to the Tax Forum, in which we have participated.

The priorities include in our view

a) Streamlining or eliminating inefficient taxes as identified by the AFTS (Henry) Review, which has major implications for state taxation and the respective state and federal tax and expenditure obligations
b) Addressing the excessive reliance on income taxation in favour of indirect taxes as identified by the AFTS (Henry) Review, including consumption taxes such as the Goods and Services Tax
c) Reducing tax impediments to drivers of Australian productivity and workforce participation
d) Introducing business tax reforms including achieving lower corporate tax rates
e) Enhancing savings and capital formation, where Australia has high tax rates as identified in the AFTS (Henry) Review
f) Simplifying individual tax and transfer rules to enhance incentive and workforce participation
g) Reducing tax and other constraints to infrastructure provision.

The Forum is an opportunity to highlight the challenges and share and develop priorities for reform. This has the potential to help create a new blueprint for tax reform and its directions.

Ernst & Young will continue to engage in the policy process after the Tax Forum, which will shape Australia's future economic environment.

LIST OF ATTACHMENTS

[2] Joint submissions of Ernst & Young with Corporate Tax Association -30 April 2009 and 17 October 2008

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Submission - 9 pages