KERRO CONSULTING
> Accounting <> Tax <> Advisory <

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Tax Forum
Treasury
Langton Crescent
PARKES ACT 2600
Email: taxforum@treasury.gov.au

Dear Sir or Madam,

TAX FORUM SUBMISSION

I refer to the opportunity to contribution to the discussion on further tax reform as part of the Tax Forum, and provide my views in this letter. As a practitioner providing accounting, tax and advisory services to small and micro businesses, and to individuals, my suggestions are based on the simplification of the taxation system, promotion of the equity of outcomes, and alignment of taxation policy with social priorities.

The areas that I believe should receive attention are, in summary, as follows:

Session 1: Personal Tax
- Simplification of personal tax system
- Simplification of deductibility of claiming work-related self-education costs
- Removal of “10% rules” in superannuation provisions
- Removal of the Medicare Levy
- Removal of the tax on death benefits paid to non-dependents

Session 3: Business Tax
- Reform of the timing of deductions for superannuation contributions
- Reform of the ‘black hole expenditure’ provisions
- Reform of the GST acquisitions provisions

Session 4: State Taxes
- Reform of insurance taxes

Session 6: Tax System Governance

- Reform of taxpayer’s objection rights
- Reform of tax collection arrangements

My detailed comments on the above issues are provided in the following pages.
Thank you for the chance to provide my views regarding opportunities for further tax reform.
Yours faithfully,
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SCOTT KERRISON
MANAGING DIRECTOR

Session 1: Personal Tax

Simplification of personal tax system

Having picked up a copy of the TaxPack 2011 from my local newsagent recently, I was dismayed to find the instructions were a veritable tome of 128 pages in order to complete a tax return of 12 pages. I did not endeavour to determine at that time how many pages of instructions and return were comprised in the separate forms and schedules that may be required by individual taxpayers. However, out of interest, I checked the TaxPack 2011 website, and found the following:

	Instructions	Forms
TaxPack 2011 supplement:	76 pages	4 pages
Business and professional items schedule for individuals:	68 pages	4 pages
Capital allowances schedule:	8 pages	2 pages

Can it be any wonder that some 72% (as cited in the Tax Forum Discussion Paper) of Australians use a tax agent? How can we possibly expect individual taxpayers to have any confidence that they will be able to avoid penalties for misrepresenting their tax position when there is clearly so much complexity in the tax system?

Even the government's much-advertised optional standard deduction for work-related expenses only has the potential to strip 23 pages (pages 27 to 49) of the 128 pages from the TaxPack. Self-assessment may have relieved the government of the burden of determining the tax position of taxpayers, but the cost has been borne by the taxpayer nonetheless.

While the government has proposed the optional standard deduction for work-related expenses and has tinkered with the tax-free threshold and low income tax offset as part of its introduction of a new (carbon) tax, it is clear that these will have little real impact on the volume of documentation and complexity that an individual taxpayer must wade through if they wish to complete their own tax return.

Simplification of deductibility of work-related self-education costs

Under present legislation, the deductibility of work-related self-education costs is unnecessarily complex and is inconsistent with global requirements for a more educated workforce, building the capacity in our workforce that the Treasurer has called for, and the continuing skills crisis in Australia.

The success of firms in the future will be less reliant on investments in physical capital, and instead will rely on a highly educated workforce. It is essential, therefore, for governments to ensure that policies are in place to provide incentives for both businesses and individuals to maximise the quality of workforce participants.

In general terms, work-related self education expenses are deductible under section 8-1 of the Income Tax Assessment Act 1997 (ITAA97). However, a deduction is not available in respect of the first $250 of certain kinds of self-education expenses, under section 82A of the Income Tax Assessment Act 1936 (ITAA36). The impact of this limit is reduced by expenses that do not fall within the definition of "expenses of self-education" (as that term is defined in ITAA36), deductions available under specific provisions (such as car expenses and repairs), and expenses of self-education that are not deductible.

This system of rule, exception and adjustment is unnecessarily complex and commonly misunderstood by individuals in practice. It should be further noted, that the potential exclusion of the first $250 does not apply where the self-education costs are paid by an

employer on behalf on the employee (i.e. where the employer claims the tax deduction). This inconsistency between the application of the deductibility of self-education costs between businesses and individuals provides further unnecessary complexity to the taxation system.

All individuals should be encouraged to continually improve their workplace skills. This can be assisted by ensuring that self-education costs are deductible in the same way as any other costs incurred in gaining or producing their assessable income, and that the complexity of claiming such deductions is, as far as possible, minimised.

In summary, the deductibility of work-related self-education costs should be aligned with social needs to ensure an educated and highly mobile workforce. The deductibility of such costs should be applied consistently between both business and individuals, and the complexity in claiming such costs should be minimised.

Removal of "10% rules" in superannuation provisions

A "10%" rule arises in two key areas of the superannuation rules; specifically the superannuation co-contribution and the personal superannuation contribution deduction rules:

- Amongst other requirements, the superannuation co-contribution requires that 10% of more of a taxpayer's total income comes from eligible employment-related activities, carrying on a business or a combination of both.

- Amongst other requirements, the personal superannuation contribution deduction requires that a taxpayer has less than 10% of their assessable income, reportable fringe benefits and reportable employer superannuation contributions being from employment activities.

The Treasurer's call for budget submissions explicitly acknowledges the long term challenges of an ageing population. However, the existence of both these rules reduces the ability for taxpayers to properly fund their own retirements; and so frustrates the ability for self-funded retirement. Instead, retirees will continue to rely on taxpayer-funded government pensions.

The "10% rule" in respect of superannuation co-contributions further entrenches the existing situation where women, who spend less time in the workforce, have significantly lower superannuation balances than men. Any substantial time spent out of the workforce, such as when raising a family makes it quite likely that the 10% rule will not be met; so the system is actively working against such individuals, but works for those earning higher income.

The "10% rule" in respect of personal superannuation contribution deduction is particularly disadvantaging to those employees whose employers who do not provide the opportunity to package their remuneration in order to contribute higher amounts to superannuation. The ability to personally claim a deduction for superannuation contributions would also provide benefit to those employees whose employers pay superannuation at 9% of only the actual gross wage (i.e. after deducting any sacrificed superannuation contributions), rather than at 9% of the nominal wage component of a remuneration package.

In addition to assisting with helping individual self-fund their retirement and saving future public funds, the removal of these "10% rules" would help in the simplification of the tax system, which has remained largely ignored in any real sense.

Removal of the Medicare Levy

The Medicare Levy was introduced with the intention of raising additional funds to contribute to the cost of public health in Australia (specifically the Medicare scheme). Whilst raising funds for the provision of public health services cannot be faulted, the basis on which those funds are raised remains open to question.

The Medicare Levy is assessed under a separate taxing act to income tax, yet it is assessed on essentially the same taxing base. In general terms, Medicare Levy is assessed at 1.5% of a taxpayer's taxable income (ignoring low income concessions and private health insurance surcharges). However, this generality is complicated by multiple thresholds, reductions and exemptions; and consequently results in higher effective marginal tax rates than the statutory rates. Given the relatively small amount that is raised under the Medicare Levy, both compared to the amount raised as income tax and in relation to the government's total health outlays, the additional layer of bureaucracy and taxation must be called into question.

Despite the government's claim to have reformed the effective marginal tax rates from 2012-13, Chart 2 of the Tax Forum Discussion Paper in fact shows that the effective marginal tax rate of someone beginning to be taxed will be higher than previously. Where the effective marginal tax rate for 2010-11 spikes to approximately 25% at around $20,000, the effective marginal tax rate for 2012-13 spikes even higher to 30% at $20,542 of taxable income (despite a statutory rate at that taxable income of just 19%).

Given the government has already shown a willingness to adjust the income tax rates and thresholds, and has acknowledged the high effective marginal tax rates as a result of the introduction and withdrawal of the Medicare Levy (in conjunction with the Low Income Tax Offset), the funds raised by the Medicare Levy should simply be absorbed into the income tax system.

Removal of the tax on death benefits paid to non-dependents

The 'Better Super' legislation implemented by the previous Liberal government undertook some of the most significant changes to the taxation of superannuation since compulsory superannuation was first introduced. However that legislation embodies anomalies in the taxation of death benefits paid to non-dependents, and these anomalies should be addressed.

Two key anomalies arise under the current legislation:

1. Despite the broad goal of simplifying superannuation, levying tax on death benefits paid to non-dependents in fact maintains the previous status quo, and retains a triplelayer of taxation – taxed on contributions, taxed on earnings and taxed on payments.
2. Despite a desire to reduce the amount of money individuals pay to financial planners to understand and maximise government-funded pension and benefit entitlements, this tax will see individuals pay financial planners to advise how to minimise or avoid the so-called 'death benefits tax'; a situation that ultimately does nothing to reduce the individual's potential financial burden on society (a key policy reason for private savings for retirement).

Except for the preservation of the revenue base, there appears to be no other reason for retaining this 'death benefits tax'. The result of this tax treatment is that non-dependent family members are faced with an erosion of the estate – erosion that notably would not be faced if assets were held in the superannuant's personal name.

Session 3: Business Tax

Reform of the timing of deductions for superannuation contributions

At present, the deductibility of superannuation contributions is governed by a specific deduction provision in the Income Tax Assessment Act 1936 ("the 1936 Act"). The deductibility provisions allow a deduction for superannuation 'paid'. This is inconsistent with the general deductibility requirement of 'incurred'. On the basis that accrued wages are accepted as an allowable deduction (which, in broad terms, are the basis for incurring a liability to make superannuation contributions), it is anomalous that superannuation must be paid before a deduction is allowed.

Whilst the policy basis of this requirement is to prevent taxpayers from accruing and accordingly deducting amounts for superannuation contributions (not yet paid), this policy outcome can be achieved with greater consistency with other deductions. Rather than denying a deduction for contributions not paid within the relevant timeframe, the penalty regime could be altered to impose the superannuation guarantee charge on top of the superannuation contributions paid (where these are paid late). The Commissioner of Taxation should, however, also have the discretion to remit such penalty.

Reform of the 'black hole expenditure' provisions

Under section 40-880, certain business-related capital costs may be deducted over a period of 5 years. This section was inserted in recognition of certain 'black hole' expenditures, that were not previously deductible or able to be included in the cost base for capital gains purposes (that is, they were not recognised by the income tax law), and thus was a significant disconnect between the economic and tax position. The same circumstances that existed for these business-related capital costs continues to be faced by entities (including individuals) that are established for investment purposes and those that are considered enterprises for GST purposes; but are not considered as businesses.

The object of section 40-880 is to make certain amounts deductible where:

- the expenditure is not otherwise taken into account;
- a deduction is not denied by some other provision; and
- the business is, was, or is proposed to be carried on for a taxable purpose.

Entities that are established for either investment-related purposes or are treated as enterprises for GST purposes likewise may incur expenditure that is not otherwise taken into account (by income tax law), is not denied by some other provision and is carried on for a taxable purpose. However, as section 40-880 specifically refers to "business", such expenditure for investment-related entities and enterprises continues to be ignored for income tax purposes. The current requirements under section 40-880 also result in continuing definitional differences between income tax law and GST law.

Reform of the GST acquisitions provisions

The Goods and Services Tax (GST) legislation is widely acknowledged as being the product of various concessions made to special interest groups. It is not clear whether it was by accident, default or design, but the GST acquisitions provisions are unnecessarily complex and hence are worthy of fundamental simplification. Of specific regard is the uneasy distinction between GST-free supplies and input-taxed supplies, and their interaction with GST taxable supplies.

For both GST-free supplies and input-taxed supplies, no GST is charged to the acquirer, but differences apply to the GST treatment for the supplier. Where a supplier provides GST taxable supplies or GST-free supplies as well as input-taxed supplies, additional effort is

required for allocating any entitlement to input tax credits on acquisitions. Specifically, the supplier must consider the relevant portion of input tax credits that relates to the GST taxable supplies or GST-free supplies (which may be claimed) and those credits that relate to inputtaxed supplies (which cannot be claimed). For example, any organisation that sells bothproducts or services and also provides the acquirer finance for that acquisition would need to consider this apportionment.

Although a de minimus financial acquisitions threshold exemption may apply (which would need to be assessed at least annually by any affected taxpayer), this is also potentially complicated by the reduced input tax credit provisions. A much simpler and cleaner position, which would significantly reduce the administrative cost of the GST system, would be to remove the input-taxed supply criteria, and have supplies as either taxable supplies or GSTfree supplies. Whilst a cost to the taxation system (i.e. reduced GST collections) would undoubtedly apply, compliance with the GST provisions would significantly improve and less business time would be spent on non-value-adding administrative efforts.

Session 4: State Taxes

Reform of insurance taxes

It has often been commented (especially when natural disasters hit) that Australians are under-insured. Part of the reason given for such under-insurance is the ever-increasing cost of insurance. The fact that insurance taxes may be charged on an amount that includes the Goods and Services Tax (i.e. a tax on a tax) no doubt exacerbates this problem.

The issue of taxes being levied on top of other taxes is an issue that has been reported since at least the introduction of the GST, and to date, successive levels of government have appeared unwilling to take any action. Aside from the inequity of being taxed in such a way, this situation also adds unnecessary complexity to business accounting to ensure that the appropriate amount of GST is claimed (it not simply being either $0 or 1/11th of the total of the acquisition cost).

A lower cost of insurance through reduced insurance taxes may have meant fewer Australians would have been so financially impacted by the recent floods and previous bushfires; and that taxpayers would not be charged with a flood levy to cover the costs of the damage caused.

Session 6: Tax System Governance

Reform of taxpayer's objection rights

Under present legislation, taxpayers have a general right to lodge an objection to a taxation objection. However, taxpayers are not given the right to receive a response to that objection. Indeed, legislation actually provides the Commissioner of Taxation with a right of deemed disallowance.

The Taxation Administration Act 1953 (TAA53) provides that if an objection decision has not been made within 60 days after the objection is lodged (or within 60 days after the Commissioner receives any further information requested from the taxpayer), the taxpayer can give the Commissioner a written notice requesting that a decision be made. If a decision is not made within 60 days after receiving the taxpayer's notice, the objection is deemed to be disallowed (s14ZYA).

Given the above position, the 'right' of the taxpayer is questionable. The Commissioner can simply ignore both the objection request and the notice requesting that a decision be made,

and the objection is deemed to be disallowed. A taxpayer must then go through the time and cost of pursuing a matter through legal means. This is an unreasonable position that clearly abrogates the ‘right’ of the taxpayer.

Reform of tax collection arrangements

If we truly are one country, and not simply a collection of colonies, then greater attention should be paid to the ease of cross-border trade between states. To date, this has been achieved on a number of fronts where nationally-consistent legislation has been agreed. However, matters of taxation appear decidedly under-represented on this list.

Page 8 of the Tax Forum Discussion Paper suggests two possible areas for consideration at the Tax Forum: are there opportunities to move towards taxation on more efficient revenue bases at each of the Commonwealth and the State levels. However, although it seems anathema to every state leader, who tightly guards “their” revenue base, surely we must also explicitly ask the question of whether additional revenue raising should be done at a Commonwealth level and returned to the States (as is done with the Goods and Services Tax).

It would seem that from reviewing Chart 1 of the discussion paper, the relatively low marginal welfare loss from the goods and services tax would suggest that current exclusions from the GST should be revisited, with offsets to be made through a combination of cuts in other taxes (such as instances of 'tax-on-tax', payroll tax and conveyancing stamp duties; from any other adjustments to the tax scales (particularly at the low end, given the proportionately greater impact of the GST on low income households); and through the transfer system.