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Tax Forum
The Treasury
Treasury Building
Langton Crescent
Parkes ACT 2600

Dear Participants,

VIRGIN AUSTRALIA'S RESPONSE TO THE TAX FORUM

We welcome the opportunity to provide feedback on Australia's taxation system, and current issues impacting upon Virgin Australia's business. This submission formalises some of the matters we have previously brought to the attention of Treasury, and also highlights some additional issues that continue to surface.

Virgin Australia requests that priority be given to the following issues, categorised in accordance with the Tax Forum Discussion Paper preferred approaches.

Reform to make the **economy stronger**, including:

(a) Entering into new tax treaties with Australia's South Pacific neighbours;

(b) Expediting the renegotiation of existing tax treaties (in particular, those with Ireland and Singapore);

(c) Amendments to domestic legislation to remove the imposition of Australian withholding tax on cross border financing of aircraft;

(d) Amendments to domestic legislation to remove the unintended taxable presence arising in Australia in relation to foreign aircraft financiers;

(e) A continuance or reduction to statutory caps for effective life of aircraft;

(f) Introduction of a number of benefits that would qualify as exempt Fringe Benefits to encourage employee behaviour that is consistent with environmental and health objectives (for example, environmental benefits and fitness benefits); and

(g) Clean technology expenditure concessions such as accelerated depreciation, investment allowance and additional R&D concessions.

Reform to make the **tax system fairer**, including:

(h) Linking revenues generated from taxes more closely with the support services upon which they are raised; and

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(i) Tax Loss carry backs.

Reform to make the **tax system simpler**, including:

(j) Harmonisation of accounting standards and taxation legislation;

(k) A reduction of the number of State and Federal taxes, including the abolition of State payroll tax and stamp duties;

(l) The ability of the airline industry to pool certain assets with the same effective lives;

(m) Increase the immediate deductibility thresholds for the acquisition of fixed assets for large corporates;

(n) Alignment of trans-tasman employee tax related issues; and

(o) Amendments to treat all entertainment as non-deducible and not subject to FBT.

These proposals relate to the following four sessions in the Forum: business tax, state taxes, environmental and social taxes, and tax system governance.

Thank you for taking the time to review the proposals in this submission.

If you would like to meet in order to further discuss any of the issues we would be more than happy to do so. Alternatively, please do not hesitate to contact me on (07) 3087 0659 if you would like to further discuss any aspect of the submission.

Yours sincerely

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VIRGIN AUSTRALIA AIRLINES SUBMISSION: AVIATION AND AUSTRALIA'S TAX FORUM

As recognised in the Government's National Aviation Policy White Paper, the Australian aviation industry provides essential air links to our vast island continent. Further, it is an important economic enabler, playing a critical role in supporting the tourism industry and regional activity. The aviation industry provides essential services to the nation and to regional economies across Australia and is influenced heavily by the events and circumstances of the global economy. Against this background, a sustainable and competitive Australian-based aviation industry is identified as a key objective in the White Paper.

The competitiveness of the aviation industry is influenced by a number of factors, including access to markets, labour, infrastructure and capital, the ability to invest and consolidate, and the cost of compliance with regulatory frameworks. The micro-economic reform of the Australian aviation industry over the last three decades has developed highly competitive domestic and international markets and world's best practice by Australia's mainstream airlines.

Nevertheless, the industry remains constrained by the tax system, both at a Federal and State level. To ensure we can meet fully the challenges of the coming decade, we support meaningful and structured reform of the taxation system.

Background on Virgin Australia

Established in 2000 as Virgin Blue, the Virgin Australia Airlines group is now an Australian publicly listed company with more than 7,000 staff.

The Virgin Australia Airlines group currently comprises the following carriers:

- Virgin Australia
- Pacific Blue
- V Australia
- Polynesian Blue (in which Samoan investors, including the Government of Samoa, have a 51% interest)

As part of the group's branding strategy, the international carriers Pacific Blue and V Australia will also operate under the Virgin Australia name by the end of 2011.

The group's carriers offer more than 3,100 flights per week and fly to 49 destinations within Australia, and internationally to New Zealand, Indonesia, Papua New Guinea, Solomon Islands, Tonga, Fiji, Cook Islands, Vanuatu, Samoa, Thailand, the United States of America and the United Arab Emirates.

The group's international network is also undergoing continued expansion through code-share, interline and/or alliance arrangements with carriers operating to regional Australia, Europe, Asia, America and the Middle East.

The Virgin Australia Airlines group's fleet currently consists of approximately 94 aircraft, including Boeing 737s, Embraers, ATR72-500s, Boeing 777s and Airbus 330s. The aircraft are secured for use by the group by various means. A number of the aircraft are owned and debt financed, originally as a direct result of a significant tightening of global leasing opportunities. Others may have been acquired through hire purchase arrangements or other particular financing structures. Finally, some aircraft are obtained through operating lease structures. Whether owned or leased, the relevant financing and/or lessor counterparties often reside in foreign jurisdictions.

In March 2010, Virgin Australia placed an order with Boeing for up to 105 x 737NG aircraft to support its fleet renewal and capacity growth objectives. As these deliveries will occur from 2011 onwards, it is imperative for Virgin Australia that the requisite financing of these aircraft are not unnecessarily constrained by additional costs or particular jurisdictions due to delays in updating Australia's treaty network.

In response to the Government's request to identify challenges and problems within the current taxation system and suggestions for reform, we have set out below a number of areas that we believe that the Tax Forum should consider more fully and to which we would welcome the opportunity for further consultation.

1. Reform to make the economy *stronger*

(a) New treaties with South Pacific neighbours

Australia's tax treaties typically contain mutual exemptions from income tax for international carriers, commonly referred to as an "Airline Profits Article". This article essentially seeks to limit taxing rights on profits arising from international aircraft operations to the carrier's country of residence. In the event that an Australian resident flies to a country with which Australia has not yet entered into a treaty with an Airline Profits Article, then there is a very real risk that profits connected with flying to/from that jurisdiction will be subject to income tax in that foreign jurisdiction. This creates a number of burdens for the Australian airline including:

(i) complexity in determining and apportioning the relevant income amount that is subject to the foreign income tax;
(ii) complexity in allocating relevant deductions to that income (this could include extreme complexity such as establishing a separate fixed asset register to calculate depreciation deductions in accordance with the relevant jurisdiction's tax laws);
(iii) requirement to understand the relevant foreign tax laws resulting in undue advisory fees;
(iv) difficulties in dealing with foreign revenue authorities;
(v) barriers in regard to language, culture, accepted business practices;
(vi) foreign currency risks;
(vii) share price implications associated with the inability to generate franking credits associated with taxes being paid in the foreign jurisdiction rather than Australia; and
(viii) where the income tax law is only applied retrospectively following a review by that foreign jurisdiction, a very real risk of double taxation.

By way of example, Virgin Australia is currently in a position of uncertainty with regard to the income tax positions in both Samoa and the Cook Islands. In both jurisdictions, Virgin Australia was unable to obtain certainty as to the treatment of income and expenditure associated with airline profits at the time of establishing those routes. The absence of such certainty has lead to a significant amount of administration, professional fees, and frustration, and yet the position remains uncertain into the future.

From Virgin Australia's perspective, these issues would not have arisen had a treaty network, or at the very least airline profits agreements, been established.

To that end, we would like to request that Australia's treaty network be extended, as a matter of priority, to include the following Pacific Islands to which the Virgin Australia Airlines group currently flies:

- Solomon Islands
- Tonga
- Cook Islands
- Vanuatu
- Samoa

If it is not considered appropriate to enter into a full taxation treaty with some of these countries, we would request that an Airline Profits Agreement be entered into as an alternative.

It is also noted that Virgin Australia is competitively disadvantaged when compared to airlines that reside in other jurisdictions that do have such or similar arrangements with these Pacific Island locations. For example, it is understood that New Zealand has reciprocal exemptions for aircraft operators with the Solomon Islands and Samoa.

Virgin Australia has a significant presence in the South West Pacific, and makes a substantial contribution to tourism in these countries. The importance of improving aviation links to encourage greater tourism, which is a critical driver of GDP in the region, has been identified by the Australian Government as part of its engagement in the Pacific through the PACER Plus agreement, which is an initiative of the Pacific Islands Forum. The development of a taxation framework that supports the competitiveness and expansion of these links would be a positive step.

In addition to the countries, and associated tax treaties, already mentioned above, in light of our expanding activities we would expect to raise this issue in relation to other jurisdictions in the future. However, we place greatest importance on advancing discussions on those countries listed above.

(b) Updating existing treaties

To enable it to access broader capital markets in securing its aircraft, Virgin Australia considers it vitally important for existing treaties to be renegotiated where they contain outdated articles regarding cross border leasing of equipment. In particular, the Singapore treaty most recently received a significant amendment in 1989, some 22 years ago, and arguably before Singapore became a globally recognised financial centre. With Australia's

current treaty position, Australian businesses may be deprived of access to these capital markets, as any exposure to such Australian taxes are most commonly indemnified by Australian companies through essentially "grossing up" interest or lease payments. Such treatment obviously increases the cost of the relevant finance.

The changes in recent years to particular tax treaties (namely the US, UK, France, Japan, New Zealand and Finland) in relation to the taxation of equipment lease rentals have been welcomed by the Australian airline industry, amongst others.

Specifically, the removal of equipment lease arrangements from the definition of "royalties" has been well received. Without these changes, the ensuing Australian royalty withholding tax is considered a major commercial impediment to inbound aircraft leasing into Australia. This is particularly due to source country taxation, on a gross basis, in this way being considered excessive when compared to profit margins on the arrangements which are relatively minor.

Secondly, modifications to the language regarding when the presence of substantial equipment in Australia gives rise to a deemed permanent establishment ("PE") have narrowed the scope for Australian income tax to be imposed on the foreign lessor's net profits.

In this regard we note that the specific words used in older treaties (such as those with Ireland and Singapore) whereby the deemed PE arises when the substantial equipment is "used" in Australia "by, for or under contract with the enterprise" have been widely interpreted in the Australian courts, to include passive as well as active use (refer McDermott's case). It is understood that the policy intention was to reserve Australia's taxing right only in respect of profits from active use/operation of equipment in Australia. In relation to cross-border dry leases of aircraft to Australian airlines, the foreign lessor does not actively use/operate the aircraft. Rather, the lessee airline (such as Virgin Australia) actively uses/operates the aircraft, derives passenger and cargo revenue, and is fully taxed in Australia on such income derived from the operation of the aircraft.

To achieve the policy intent, Virgin Australia suggests when treaties are amended, that any deemed PE provision in relation to substantial equipment should have clear language limiting the possibility to when the equipment is "operated" in Australia by the foreign resident (ie, similar to the language in the New Zealand treaty).

The combination of the above changes is considered economically progressive and has assisted in securing access to aircraft from lessors in markets where treaties have been renegotiated in this way. Countries with amended treaties, however, remain at a competitive advantage over those without these changes. The lease rental income of the foreign lessor who resides in countries with treaties that have not as yet been amended would be subject either to Australian income tax or withholding tax. Although, the lease income is that of the foreign lessor, the generally accepted practice contractually is to pass on any such burden to the lessee, by way of contractual indemnity or the like. In effect, therefore, the foreign lessor's Australian tax becomes an additional cost to the Australian lessee in obtaining such equipment. Obviously this limits Virgin Australia's access to foreign markets and places Australian lessees, like Virgin Australia, in the position of having an even higher effective tax rate, placing further economic burden on the airline.

Furthermore, we would like to see consideration of the tax position of two-tier leasing structures (ie, a head-lease and sub-lease scenario), when the sub-lessor is a resident in a country that does have an updated tax treaty. Essentially, the current position adopted is that if the head-lessor is resident of a country that does not have an updated treaty, then based on Australian Taxation Office ("ATO") published opinion (refer TR 2007/11) Australian income tax will be assessed on head-lease payments.

In this scenario, it is the treaty of the head-lessor's jurisdiction that deems the royalty income to be Australian sourced. Without this deeming of source via the treaty, the foreign lessor would not be subject to Australian income tax or withholding tax under the domestic legislation. The treaty seeks to potentially bring an amount into the Australian tax net that would not otherwise have been subject to tax in Australia had the head-lessor instead been a resident of a non-treaty country.

We question whether it is economically intended and sound that transactions being conducted with a resident of a tax treaty country should result in increased tax burdens when compared to an identical transaction with a resident of a non-tax treaty country.

Until such time as all double tax treaties are amended in a manner consistent with the above-outlined changes, jurisdictions with tax concessions (no withholding tax or income tax) will be favoured over those which do not offer such tax concessions. The removal of these impediments will increase competitiveness of investors (foreign and domestic), ultimately assisting Australian companies to raise capital and allow themselves to become more competitive in the global environment.

We acknowledge that Treasury is in the process of negotiating tax treaties with various jurisdictions in order to remove such complexity, impediments and uncertainty. However, the delay in re-negotiating treaties results in jurisdictional bias occurring in making capital investment decisions. Virgin Australia would therefore like to see the expedition of treaties being updated in a manner consistent with the New Zealand treaty. Of particular priority are the Ireland and Singapore treaties, as there are several potential and existing financiers and/or lessors that reside in these jurisdictions.

We understand that various bodies have calculated that the potential impact to Federal Revenue in relation to the removal of such hurdles to be minimal.

(c) Removal of withholding tax on cross border aircraft financing

As discussed above one of the major inhibiters to aircraft financing decisions, and a significant driver of frustration for both Virgin Australia and any potential foreign financing company, relates to withholding taxes. To improve access to foreign investment for Australian companies, interest withholding tax and royalty withholding tax on equipment leasing should be reduced or ideally abolished, such as they have been in the recent amendments to certain tax treaties.

Until such time as all tax treaties are amended in such a manner, jurisdictions with tax concessions (no withholding tax) will be favoured over those which do not offer such tax concessions. In order to remove such frustration, and improve access to a broader community of international finance providers, Virgin Australia submits that to circumvent the lengthy process associated with treaty negotiations, the intended requisite reform should instead be made to Australia's domestic tax law on a unilateral basis by:

- Removing Australian royalty withholding tax on cross border equipment leasing; and
- Removing Australian interest withholding tax on debt financing from foreign financial institutions;

In this regard it is submitted that no difference should arise as to whether borrowing to finance acquisition of equipment occurs or whether equipment is leased.

Amendments to abolish interest withholding tax and royalty withholding tax will provide Australia's capital intensive industries with improved access to foreign capital markets and eliminate the current competitive disadvantages.

Recent tax reforms to the shipping industry include exemption from royalty withholding tax liability for foreign owners of vessels where the vessel is leased under a bareboat charter to an Australian company. Similarly, these changes to domestic legislation should be extended to the Australian airline industry to improve its access to foreign capital for investment in aircraft.

(d) Removal of unintended tax presence in Australia for foreign aircraft financiers

The ATO's recent published position on equipment leasing, in the context of determining whether a PE is found to exist has created unnecessary complexity and unworkable guidance to lessees within the airline industry who, commercially, are compelled to indemnify foreign lessors' exposures to Australian taxation (whether income tax or withholding tax).

We acknowledge that Treasury is in the process of negotiating tax treaties with various jurisdictions in order to remove such complexity. However, the delay in re-negotiating treaties results in jurisdictional bias occurring in making capital investment decisions.

We therefore propose that the domestic definition of PE be amended such that (a) it does not include the leasing of substantial equipment (except where the equipment is used to exploit natural resources), or (b) a PE only arises when substantial equipment is "operated" in Australia by the relevant foreign lessor and that entity carries on business in Australia.

The above changes to the domestic legislation, resulting in the removed ability to tax income of foreign lessors via withholding tax or income tax, should not have a major impact on Federal Revenue. The fundamental reason for this is that financing that results in such taxes is unlikely to be entered into in the first instance, due to the additional burden on either Virgin Australia, or the financier themselves. These proposed changes also reflect the policy intent which is reflected in the most recently revised treaties.

(e) A continuance or reduction to statutory caps for effective life of aircraft

In a global sense, Virgin Australia is not operating on a level playing field with respect to global competitors in the airline industry. There are a number of specific examples of this, including the fact that other airlines are either partly or fully Government owned, or receive significant Government support. Further to this, such airlines are also able to depreciate aircraft over very short periods of time, the most extreme example being Singapore with a three (3) year statutory cap on effective life. Australia presently has an effective life over which aircraft can be depreciated for tax purposes of 10 years.

The Henry Review commented on "reviewing special provisions" for depreciation, to align effective and actual asset lives. While the effective useful life for commercial jet aircraft is generally in excess of 20 years, the effective economic life (in terms of running cost and environmental footprint) is significantly lower, when factoring in major maintenance events.

The introduction of the capped effective lives for certain depreciating assets was considered the most efficient, transparent and balanced method of meeting the needs of the airline and other specific industries whilst maintaining the integrity of the Government's effective life capital allowances system. Therefore, maintaining or reducing current effective lives would assist airlines in investing in newer more environmentally efficient aircraft and engine technology sooner, thereby bringing forward the related reduction in carbon emissions.

Any increase to the current statutory effective life would have a significant effect on forthcoming investment projects and put Australian airlines at a further competitive disadvantage to its international competitors.

Furthermore, such a measure would be inconsistent with recent Government tax reforms for the shipping industry, where Minister Albanese announced, and reiterated in his speech this morning (29th September), the effective life for shipping vessels has been cut in half from 20 years to 10 years. This accelerated depreciation of vessels has been introduced to assist Australian shipping operators in competing against foreign operators that enjoy favourable taxation arrangements. The expected benefits from these reforms to the Australian shipping industry include: reduction to operating costs of older vessels; safety and environmental benefits of newer vessels that incorporate new technology; and, increased employment as ship building is encouraged. Such benefits would be equally apparent in the Australian airline industry.

The airline industry faces similar international tax disadvantages to the shipping industry and in light of the recent shipping tax reforms, the removal of the current depreciation concessions for aircraft would be discriminatory. Further, the cost to airlines of any potential increase to the current statutory effective life of aircraft, when passed to the consumer, would impact consumer decisions and discourage domestic travel, tourism and employment.

(f) Introduction of new exemptions for certain fringe benefits

(i) Environmental Fringe Benefits

Notwithstanding the imposition of a price on carbon, we submit that also reforming the Fringe Benefits Tax ("FBT") regime so that certain "environmental" fringe benefits are exempt from FBT would directly encourage Australians to live in a more sustainable way.

It is proposed that a "Clean Energy Benefits Scheme" is implemented. Under such a scheme the employer would provide certain sustainable benefits to employees who could also salary sacrifice such benefits. Examples of the types of expenditure or benefits that would be covered under such a scheme could include public transport, car pooling, hybrid cars, green/fluorescent lights, bicycles, solar hot water, solar power, home insulation, rainwater tanks, and grey water recycling. If the provision of such benefits to employees were exempt from FBT, this would encourage the use of such sustainable goods and services as Australians could personally invest in environmental practices using their pre-tax salaries.

Other benefits of implementing such a scheme include:

- job creation in sustainable industries;
- social benefits through improved standard of living;
- potential health benefits through incentives such as cycling, public transport; and
- infrastructure benefits resulting from public transport utilisation, or encouraged car pooling.

To incentivise employers to introduce the proposed Clean Energy Benefits Scheme, it is further submitted that the employer would be able to avail itself of any relevant "Carbon Credit" attached to the staff benefits, to be either offset against its annual Carbon Permit liability, or sold to another organisation for use against its Carbon Permit liability.

(ii) Fitness Fringe Benefits

It is proposed that the FBT legislation also be changed to create a greater level of incentive for the Australian workforce to undertake regular exercise to improve their health, wellbeing and productivity.

As the rates of obesity continue to increase so too do the incidences of associated related illnesses and diseases which add to the strain on the Australian budget. The costs to the Australian economy arise from direct health care costs and also from indirect costs such as decreased workplace participation and productivity. This financial burden provides a clear financial incentive for the Government to invest in policies which encourage physical activity and thereby reduce the incidence of obesity and related illnesses amongst Australians.

It is recommended that the current FBT exemption that applies to fitness benefits to employees be expanded. Currently the exemption only applies to access to fitness facilities that are provided on the employer's business premises. The costs and

impracticalities of managing an on-site fitness facility for an employer means that the exemption has limited application in practice. It is therefore submitted that the FBT exemption for fitness benefits should be amended so that the qualifying fitness benefits no longer need to be provided on the employer's premises. This would provide an incentive for more employers to provide fitness benefits to employees. In turn, this would increase the affordability and accessibility of fitness benefits to employees and lead to greater physical activity participation levels across Australia. It is anticipated that the costs in implementing such a change would be outweighed by the benefits generated through improvements to the health and productivity of the workforce.

(g) Clean technology expenditure concessions

It is proposed that new measures be introduced into the income tax legislation to facilitate accelerated depreciation, additional investment allowances and/or additional R&D concessions for new clean technology capital investments. This measure will encourage business and investors alike to redirect their capital spend sooner on clean technology as the after-tax return will be higher in the short-term.

As some clean technology is already developed overseas it is proposed that Australian taxpayers should receive excise and customs concessions in bringing this technology into Australia. Further, the costs of implementing technology to Australian conditions should also be eligible for accelerated depreciation and investment allowances.

The Clean Energy Future plan proposes to allow eligible small business owners to claim an immediate tax deduction for assets costing up to $6,500. The instant asset write-off will allow small businesses to invest in more energy efficient equipment and benefit from improved cash flow. It is submitted that this measure should be available to all taxpayers to encourage larger scale investments with a greater impact on carbon emissions.

2. Reform to make the tax system *fairer*

(h) Linking revenues generated from taxes more closely with the support services for which they are raised

We support the concept that specific taxes that are levied to cover specific outlays should be quarantined and used solely to support services for which they are raised.

<u>(i) Customs, Immigration and Quarantine Services</u>

The current practices of cost recovery for Customs, Immigration and Quarantine (CIQ) services through a Passenger Movement Charge (PMC) needs to be critically re-examined. Funding the future expansion of essential CIQ facilities to the extent envisaged in the demand forecasts inevitably will increase pressure to expand the PMC, which in turn will increase the administrative and cost burden on airlines; increase air fares and impact negatively the demand for air travel. The essential question is where the ultimate benefit is derived from these services. We do not believe the principal beneficiaries of CIQ are airline passengers, but rather the broader community.

Where national interest considerations are clearly the paramount driver of the regulatory measures, a tax imposed exclusively on the aviation and tourism sectors appears to be inequitable. Removal of this tax on the industry will assist in ameliorating the impact of the escalating cost of fuel and the impact of the carbon price on the aviation and tourism industries.

(ii) Clean Energy Plan

The Revenue collected from the airline industry as a result of the Clean Energy Plan should be put back into the industry to support measures to find alternative fuel sources, including providing additional capital allowance incentives to encourage investment in designing more fuel efficient aircraft.

(i) Tax Loss Carry Back

Given the high level of variability of airline profits, we recommend the introduction of a loss carry back regime similar to those available in Canada and the United States. Because assessing tax payable is arbitrarily broken into defined yearly periods, a period of high taxable income can be followed by tax losses. No relief however is given for taxes previously paid when falling into losses, even though, economically, over time, a taxpayer is in an overall tax loss position. Jurisdictions such as Canada permit the carrying back of tax losses for three years, capped at the level of taxes paid in that period.

The 'Henry Review' of Australia's Future Tax System recommended that companies be allowed to carry back a revenue loss to offset it against the prior year's taxable income.

Airline profits are highly seasonal and subject to external shocks as seen with the recent flooding, cyclones and volcanic ash events. A tax loss carry back regime would effectively address the volatility in annual performance of the airline industry and provide assistance to the industry during downturns. Permitting the carrying back of tax losses for three years, capped at the level of taxes paid in that period, would assist considerably in sustaining a long-term view of investment in Australian tourism.

Over time, the impact on Government tax revenues is not significant because tax losses which are carried back will not be available to be carried forward.

3. Reform to make the tax system *simpler*

(j) Harmonisation of accounting standards and taxation legislation

In Australia, there is very little connection between the income tax law and accounting concepts or standards. There is a practical interdependence between accounting and taxation. Many business taxpayers calculate their taxable income or tax loss in practice by reconciling from their accounting profit or loss. The key observation here is that accounting records and calculations are a vital part of the practical application and administration of the income tax system, even for those taxpayers who do not have to comply with accounting standards.

Currently, fundamental concepts such as the point at which income is derived, expenditures are incurred and prepayments of expenditure are allowable are divergent in their treatment for accounting versus tax purposes.

Whilst large companies are continually generating financial statements on financial performance, which in most cases are required to be externally audited, it would significantly simplify the tax laws if the timing of income and deductions were completely aligned with accounting principles. In addition, it would provide more clarity to investors on understanding the current and deferred tax liabilities of the company.

(k) A reduction in the number of State and Federal taxes, including the abolition of State payroll tax and stamp duties

A number of the more inefficient and regressive taxes were intended to be abolished with the introduction of GST, including payroll tax and stamp duty.

The State Payroll Tax and Stamp Duty regimes are extremely complex and administratively burdensome, especially for companies such as Virgin Australia with national operations. Ideally, we would prefer the full abolition of these State-based taxes.

Short of abolition, we support a federalisation of such State-based taxes to resolve the issue of all States having different taxable definitions, tax rates, payment timeframes and reporting obligations.

The States and Territories themselves acknowledge that harmonisation is a priority. Despite this objective, by way of example, some States have difficulty in agreeing who has taxing rights over wages where an employee works in more than one State, even though those States have near identical legislative provisions. This arises from having States competing for revenue. This level of administrative complexity and compliance is economically regressive for businesses operating in at least more than one State.

If the abolition of these taxes is not achievable, creating a Federal responsibility for collecting all taxes would lead to significant synergies for governments and provide aggregate and reduced compliance cost for business. This would also allow for harmonising the administrative practices in relation to the way these taxes are applied and would significantly reduce business compliance costs.

(l) The ability of the airline industry to pool assets with the same effective lives

Broadly, entities operating within the airline industry (and presumably other industries) commonly utilise certain asset pooling allowances in relation to financial reporting requirements. For assets such as spare parts, engines, rotables (parts that can theoretically can be repaired an infinite number), repairables (can only be repaired a finite number of times), a pooling mechanism would remove a significant amount of administration, specifically where such assets are transferred from one aircraft to another, or from an aircraft to the workshop.

As a consequence of the constant movement of assets within the business, it is extremely difficult to calculate tax depreciation, and related balancing adjustments, in an accurate manner, as technically required by Division 40. Instead, like other members of the airline industry, Virgin Australia's tax team rely on a conservative approach to calculating and claiming decline in values over the effective life of these assets, and associated balancing adjustments. This is largely in line with the principles adopted for a "low value pool".

In this regard, Virgin Australia submits that new tax depreciation rules should be considered, allowing taxpayers to adopt a pooling mechanism in calculating the decline in value or certain depreciating assets, that are of a similar nature, are interchangeable and have the same, or similar effective lives.

Only detailed modeling would determine the impact on Federal Revenue, however the important advancement would be to simply reduce uncertainty and administrative burden for simple timing outcomes.

(m) Increase the immediate deductibility thresholds for the acquisition of fixed assets for large corporates

Presently, small business entities are provided with taxation concessions including an immediate deduction for depreciating assets costing less than $1,000 each (low-cost assets). Treasury has released new draft legislation increasing the small business instant asset write-off threshold from $1,000 to $6,500. However, for businesses that do not meet the eligibility requirements, the threshold to claim an immediate deduction for business expenditure to acquire tangible assets is reduced significantly to $100.

As mentioned above, large companies are continually generating audited financial statements which specifically include stringent accounting policies governing the capitalisation of assets. For Virgin Australia, an asset which costs in excess of $1,000 is recorded individually on the accounting fixed asset register. It is common practice for a business to use its accounting fixed asset register as the basis for a separate tax fixed asset register which applies the capital allowance provisions, including depreciation rates based on effective lives under the tax legislation. It is impractical to record assets that cost less than $1,000 for tax purposes where they are not originally identified and recorded for accounting purposes.

Whilst the low value pooling mechanism can be used for assets costing less than $1,000 and this does ease the requirement of individually recording these assets for income tax purposes, it still is administratively burdensome as these assets are not usually captured for accounting purposes. The ATO acknowledges the burden placed on large businesses that do not have processes which record, identify and account for low-cost items and the Commissioner does allow a sampling approach.

It is proposed that assets costing less than $1,000 should be immediately deductible for large businesses. This measure would not result in any tax revenue leakage over time as it is effectively only changing the timing of the deduction. This measure would relieve large taxpayers from the onerous administration of separately identifying such assets when reliance on accounting procedures would be more appropriate.

(n) Alignment of trans-tasman employee related tax issues

With Australian companies increasingly conducting business in New Zealand or contracting with New Zealand businesses, a move to aligning the New Zealand and Australian tax laws would encourage cross border investment and the efficient conduct of business.

Currently, the misalignment of tax legislation creates significant complexity, compliance and administration, examples of which are:

- Movement of employees – most tax treaties provide relief from personal income tax where an individual spends less than 183 days in a country (say, an Australian employee working in New Zealand), however, this exemption does not apply where their employer has a place of business in that other country (New Zealand). This gives rise to personal income tax liabilities for the employee and associated withholding obligations on the employer from day one, even for short-term assignments. This system is extremely complex and administratively burdensome, and we would recommend moving towards individuals only becoming subject to tax in New Zealand where their primary place of employment or residency moves to New Zealand (and vice versa for New Zealand employees undertaking duties in Australia).

- the absence of a bilateral social security agreement between Australia and New Zealand, ultimately imposing the cost of "double superannuation coverage" on an employer with employees working in NZ whilst still covered by the Australian super guarantee scheme; and

- the potential for superannuation support in Australia being subject to FBT in New Zealand.

(o) Amendments such that all entertainment is non-deducible and not subject to FBT

All entertainment (including food and drink) should be non-deductible to simplify the FBT process. With the application of the minor benefit exemption, the amount of FBT payable on entertainment is progressively declining in any event and largely results in this outcome.

Where the 50-50 concession is accessed, whereby half all meal entertainment expenditure is treated as non-deductible and not subject to FBT, the minor benefit exemption is lost. Accordingly, the information gathering process becomes onerous for large corporates where minor benefits are provided to employees. Furthermore, the application of the ATO's published opinion and "entertainment matrix" does not encompass all entertainment scenarios and is confusing to apply where the exact recipient of the entertainment is not captured and the resulting treatment can vary upon the exact circumstances of that recipient, eg. away from usual workplace, travelling, travelling alone or with company, etc.

Furthermore, the interaction of monthly reporting for the Goods and Services Tax, and annual reporting with different year ends for income tax and FBT, create additional reporting burdens requiring adjustments and amendments to returns. Where all entertainment is non-deductible and not subject to FBT the income tax and GST treatment can be determined upfront without having to ascertain the FBT treatment as part of the annual FBT compliance.

This measure would simplify reporting for taxpayers and any loss in FBT revenues would be compensated for by increases to income tax and GST revenues. Overall, the administration required to ensure compliance with the overly complex entertainment rules is a burden on taxpayers that could be removed without impacting overall Federal Revenue.