



The National Institute of Accountants

Submission to the Review of Australia's Future Tax System

May 2009



## The National Institute of Accountants

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The National Institute of Accountants (NIA) welcomes the opportunity to make this further submission to the Review Panel on Australia's Future Tax System, which is widely considered to be the most significant review of Australia's tax-transfer system in the last 50 years.

The NIA is one of the three recognised professional accounting bodies in Australia, representing over 20,000 accountants, business advisers, academics and students throughout Australia and internationally. The NIA has been active within the Australian and international environment since 1923 and prides itself in not only representing the interests of its members but also the accounting profession in general as well as the public interest more broadly.

It is also worth noting that approximately two-thirds of NIA members have an interest in small business, either through owning a small business (professional practice), being employed in a small business or having small businesses as clients. Accordingly, our submission is made from the small business perspective of our members as well as the interests of the wider accounting profession and the public interest.

In this second submission to the Review Panel, the NIA has focused on specific questions being posed by the Panel, which are of particular interest to our members. In this regard we have largely relied on the views and recommendations made in our first submission and which we consider are worth repeating.

If you have any queries or require further information with respect to our submission then please don't hesitate to contact Vicki Stylianou on either (02) 6260 8619 or 0419 942 733 or [vicki.stylianou@nia.org.au](mailto:vicki.stylianou@nia.org.au).



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## **Introduction**

The NIA considers the Panel's consultation paper to be a valuable extension to the earlier Architecture Paper, to which the NIA made a substantive submission in October 2008 based on extensive member consultation across Australia. In response to the Panel's consultation paper, we rely on our first submission and note that our views and recommendations remain the same as set out therein.

For ease of reference, we have listed below the recommendations made in our first submission, without repeating the detail of these recommendations. Instead, we have, as mentioned above, restricted this second submission to some of the specific questions posed by the Panel, which are of the most relevance to our members.

## **List of recommendations**

The Review Panel should consider the following:

Recommendation 1: Encouraging workforce participation by increasing the level of the tax-free income threshold relative to unemployment and welfare benefits.

Recommendation 2: Implementing innovative ways of increasing retirement incomes; including extending the small business Capital Gains Tax (CGT) concessions to other categories of taxpayers.

Recommendation 3: Rationalising and streamlining pensions, concessions and allowances with an emphasis on reducing complexity, duplication and inefficient programs.

Recommendation 4: Developing and implementing measures which delay retirement by seeking to influence the timing of retirement without penalising those who wish to retire early.

Recommendation 5: Encouraging and supporting the retention and re-entry of mature age workers into the workforce, including adequate skilling.

Recommendation 6: Removing the 15 per cent contribution tax on superannuation contributions to encourage more contributions and provide a non-stimulatory form of tax reform. Superannuation funds should be exempt from tax on all income and gains with payment of benefits to members being taxed at their marginal rate.

Recommendation 7: Abolishing the '10 per cent rule' on the deductibility of superannuation contributions to give greater flexibility for those people who have to make their own superannuation provisions.

Recommendation 8: Treating superannuation death benefits consistently in the legislation and that all such benefits should be tax-free whether to a dependent or non-dependent.



Recommendation 9: Continuing to ensure that taxpayers are well aware of their obligations surrounding Self Managed Superannuation Funds and are seeking appropriate professional advice.

Recommendation 10: Educating and better preparing taxpayers for retirement through simplifying the superannuation system which is still considered overly-complex.

Recommendation 11: Undertaking a major review of the Fringe Benefits Tax system.

Recommendation 12: Reforming CGT to include consideration of a scaled rate of CGT; and improving the operation of the CGT rules.

Recommendation 13: Reducing complexity in the tax laws including finalising the rewrite of the tax laws into a single, streamlined Act.

Recommendation 14: Reviewing the system of State and Territory taxes with the objective of removing, simplifying and streamlining the imposition, collection and distribution of the remaining taxes; and with an emphasis on harmonising taxes in all States and Territories.

Recommendation 15: Increasing efficiency and reducing complexity by consideration of the State and Territory governments referring the administration of their tax systems to the ATO.

Recommendation 16: Reducing the distribution and level of benefits through the transfer system with the objective of encouraging workforce participation and improving equity for all taxpayers.

Recommendation 17: Developing an entirely separate tax regime for small business based on a lower rate of tax.

Recommendation 18: Reviewing the company tax rate in order to build and maintain international competitiveness.

Recommendation 19: Encouraging environmentally friendly behaviour by taxpayers by introducing a range of targeted concessions.

Recommendation 20: Making the filing of individuals' tax returns optional.

Recommendation 21: Encouraging the establishment and sustainability of new businesses through a wider range of incentives.

Recommendation 22: Improving equity by removing the Luxury Car Tax or reducing the applicable rate.



Recommendation 23: Broadening the tax base and increasing efforts to remove or reduce the use of exceptions and exemptions in the tax laws.

Recommendation 24: Ensuring that tax laws do not operate retrospectively except for the benefit of taxpayers.

Recommendation 25: Removing the taxation of interest on funds held in bank accounts and other financial institutions.

Recommendation 26: Removing taxes judged as inefficient by their compliance burden and the amount of revenue collected.

Recommendation 27: Improving the administration of the tax system by the ATO giving greater weight to flexibility and commercial reality.

Recommendation 28: Encouraging the use of technology in the tax system (especially the administration) as a means of reducing compliance costs.

Recommendation 29: Reviewing the interaction between the tax system and accounting standards to ensure there are no unintended consequences.

Recommendation 30: Ensuring that demutualisations are not subject to CGT or only upon sale of the asset.



In response to the questions posed by the Panel in its consultation paper, the NIA makes the following submission.

**Q1.1: Which key features should inform or drive the future design of the Australian tax-transfer system?**

The NIA believes that the need to reduce the complexity of the tax-transfer system should be given the highest priority in reforming the system. The need for simplicity should be the key driver for the future design of the tax-transfer system. In addition to the economic efficiency gains, it is apparent that for many stakeholders this is a monumental and ongoing issue, which pervades most other areas of interaction with the tax-transfer system. The issue of complexity was overwhelmingly endorsed by NIA members as the greatest single impediment to an efficient and effective tax system.

As acknowledged by the Panel, the complexity of the tax system continues to be widely considered as one of the major burdens and impediments for business, with a disproportionate impact on small business and those with the least resources. A genuine reduction in the complexity of the tax system would reduce the compliance burden for all taxpayers and the administrative burden for the ATO and government. The NIA's submission has made various suggestions for achieving greater simplicity in the tax-transfer system.

**Q4.12 In a targeted system there is a trade-off between the level of income support and workforce incentives. Given this, what priority should be given to reducing the disincentives to work?**

**AND**

**Q4.13 What structure of income tests and taxes would best support the increasing diversity of work and the need to increase workforce participation, and where should improved incentives be targeted?**

The NIA considers that the issue of encouraging workforce participation, especially given the ageing population (and in a post-global financial crisis (GFC) economy) to be a major consideration if Australia is to achieve sustainable economic growth. In the NIA's consultation with members, the issue of encouraging workforce participation was one of the major topics of concern.

The NIA's submission emphasized that the Government should consider not only the removal of disincentives for workforce participation, but also ways to build in positive incentives for workforce participation. One option is to delay retirement by offering lower rates of income tax.

The Organisation for Economic Co-operation and Development (OECD), work on this issue is particularly useful and the NIA has made considerable reference to it in



developing and supporting our recommendations. As documented by the OECD, Australia's labour market participation rate is below the OECD average. Given the changing demographics documented in Treasury's *Intergenerational Report 2* it appears imperative that people be encouraged to enter or re-enter the workforce. Obviously, one option to achieve this is to reduce effective marginal tax rates, especially at the bottom of the income scales, which has been the subject of ongoing attention.

One suggestion is to increase the tax-free income threshold, over a period of time. Welfare payments, which are indexed, have over the last couple of decades become progressively higher than the tax-free income threshold, which is lower than the unemployment benefit. The low income tax rebate does not go far enough in addressing this imbalance. In a post-GFC economy this may be a viable option, even though there would be trade-offs to counter the loss to revenue.

Another major benefit with increasing the tax-free income threshold is the reduction in complexity from being able to remove a range of deductions and rebates from the system.

Other suggestions for increasing workforce participation include:

- Pensioners should be incentivised into the workforce, for example, by considering investment income as the major source of income and not including work/labour income (or not including work income above a certain amount) for tax purposes.
- Providing more incentives through the tax system to encourage employers to hire more apprentices as the current level of government support is considered inadequate.
- Encouraging apprenticeships by having accounting and business students spend at least, one day per week working in a firm. This will prepare them more usefully for full-time employment after graduation.

#### **Q5.6: Should the tax system be structured to cater for the specific circumstance of small business, and if so, how?**

As mentioned above, the NIA has a particular interest in small business as approximately two-thirds of our members work in and around small business. The NIA is also a Board member of the Council of Small Business of Australia (COSBOA).

It may be worth repeating the NIAs submission with respect to the development of a separate tax regime for small business.

The main feature would be a lower rate of tax (say 20-25 per cent) for small business. Small business could be redefined in terms of meeting two out of three criteria based on turnover, assets and number of employees; alternatively, it has



been suggested that small business be defined as businesses with turnover of less than \$25 million.

Deductions, depreciation and other complexities would be removed in return for the lower rate. If the loss of revenue became an issue then either the definition threshold could be reduced or we suggest a simplified system with the following features:

- all assets valued at less than \$5,000 would be immediately deductible in the year the expense is incurred;
- all assets (other than real property) valued at between \$5,000-\$50,000 would be apportioned over three years;
- all assets valued at greater than \$50,000 would be treated according to normal depreciation rules;
- real property would be treated in accordance with the tax laws;
- small businesses would be exempt from all State and Territory taxes and duties (except relevant workplace laws at the time);
- there would be no exceptions or exemptions for any industry sector or otherwise; and
- the ATO would be sole administrator of the system.

The regime could allow the small business to have any structure or entity. Unlike the previous Simplified Tax System, which was meant to be targeted at small business, this regime would aim to be simple in design, operation and practice. Overseas models, including South Africa, should be considered.

**Q8.1: Which taxes or transfers are the most complex and impose the greatest costs? How should these costs be reduced (by abolishing the taxes or transfers or by making the rules applying to them simpler)?**

The most discussed topic among NIA members at the consultation meetings across Australia was Fringe Benefits Tax (FBT) and the need for serious reform of Australia's FBT regime. Since then, we believe an expectation has been raised that there will be reform of the FBT regime either as a result of this Review or at some future time.

As mentioned in the Panel's consultation paper, one of the main issues is whether fringe benefits should be taxed in the hands of the employee rather than the employer, as was recommended by the 1999 *Review of Business Taxation* (the Ralph Review). The 2006 report *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (the Banks Report) also considered FBT



and recommended that the Australian Government should limit reporting of fringe benefits to remuneration benefits only. That is, real business expenses should not be included, such as those relating to business entertainment. NIA members were generally in favour of fringe benefits being taxed in the hands of employees.

The Banks Report also stated and it was also overwhelmingly endorsed by NIA members that the revenue gained by FBT was disproportionate to the compliance burden it created. NIA members consistently referred to the compliance 'nightmare' created by the FBT regime.

Suggestions from NIA members include allowing businesses a maximum rate of benefits per employee or a total amount (based on the number of employees; eg \$1,000 per employee or \$5,000 for senior executives); having a higher rate for not-for-profit organisations or small businesses; having a specific list of inclusions and exclusions as to what is considered a fringe benefit (eg education/training and remote area allowance is not included in the limit).

Whilst NIA members were unanimous that the FBT system needed serious reform, there was division as to whether or not FBT should be totally abolished. There was general support for the proposal that fringe benefits should be taxed but it should be through the income tax system in the hands of the employee rather than having a separate system. In addition, that fringe benefits should be taxed at the taxpayer's marginal rate of tax (though some were in favour of penalty rates applying).

It is also worth repeating, given the unanimous level of support from members, that the FBT year should be aligned with the financial year. It was felt that the original reason of spreading the tax agent's work was no longer relevant.

**Q9.2: Given the widely held view in submissions that the current state tax arrangements need to be reformed, what changes should be made to state and local government own source revenue instruments? What scope is there for greater user charging to bring social, environmental or economic benefits?**

The NIA is a member of the Business Coalition for Tax Reform (BCTR) and we endorse most of the recommendations in the second submission made to the Panel. We are also in support of the BCTR/Centre for International Economics report on *State business tax reform – Seeding the tax reform debate*, which we understand has been forwarded to the Panel under separate cover. We would urge the Panel to consider the material and proposals in that report.



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