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keepin' it simple

Henry Review - submissions

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date	18 October 2008
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subject	**Submissions to Australia's Future Tax System review**

batallion legal is pleased to make submissions to the Australia's Future Tax System review.

Our submissions are the combined effort of our current team, namely: Luis Batalha, Wilson Lee, Jonathan Lim, Wai Kien Ng, Pascal Gour, Arnaud Colson, Dhiwa Sathananthan and Arash Azimi.

1 Summary

1.1 The following table summarises our submissions:

Issue	Submission

Balance of taxation of labour, capital & consumption; environmental taxes	▪ development of a centralised system and/or centralised administration body for tax collection and transfers; ▪ indexation of the level of transfers to inflation and indexation of tax rates to inflation; ▪ reduction of the corporate tax rate, and potentially an expansion of the corporate tax base; ▪ abolition of CGT for entrepreneurs and small businesses; ▪ permit an election for mark to market for all CGT assets, to prevent hoarding of assets due to taxation upon realisation; ▪ provision of tax incentives for new energy technology and tax exemptions to corporations that deal in and introduce new forms of energy; ▪ provision of tax credits for low-emission vehicles and additional taxation for high-emissions vehicles; ▪ introduction of tax deductibility for environmentally friendly products, environmentally friendly activities, etc (eg bicycles and public transport usage);
Tax & transfer payment system for individuals, working families & retirees	▪ creation of a net monthly payments system instead of separate provision of transfers and receipt of tax; ▪ development of one reporting tool, namely a tax and transfer form, rather than multiple reporting to various government departments; ▪ creation of new work incentives by restructuring the tax system, in order to combat the ageing population problem (including the development of different tax rates for individuals of different ages). In particular, lower tax rates should apply for young individuals and for older individuals.
Taxation of savings & investments	▪ the introduction of "carry back" provisions for corporate tax in Australia's tax system; ▪ reduction of the rate of company tax in Australia to encourage further foreign investment; and ▪ the taxation of superannuation funds should be abolished.
State taxes	▪ abolition of inefficient transaction taxes (including all stamp duty on businesses); ▪ harmonisation of the definitions and bases of the different taxes and consistency across different States and Territories of Australia; ▪ creation of a central body responsible for the administration of all State and Territory taxes.

Tax administration	▪ removal of taxes that generate low revenues and have a high compliance costs; ▪ creation of a centralised collection agency for businesses; ▪ creation of a single government entity to collect taxes; and ▪ small businesses should be given the option of reporting on an annual basis, rather than a quarterly basis, eliminating the quarterly BAS system. Or alternatively, PAYG withholding and superannuation contributions should be the responsibility of employees in the case of small businesses.
Interrelations between tax systems and the emissions trading system	▪ consider alternatives to carbon trading system, like providing tax incentives to businesses investing in environmentally friendly initiatives and encouraging greater use of public transport; ▪ tax deductions should be increasingly tied to environmentally friendly behaviour rather than income producing behaviour. For example, tax deductions could be available for walking to work (as an activity), use of environmentally friendly products, or simply reducing the level of energy consumption in a household. In fact, this is a preferable approach to the environmental issues currently confronting the world, rather than the carbon trading approach; ▪ creation of a bail-out fund for companies affected by the carbon trading scheme; ▪ creation of a tax-neutral highly regulated secondary market for carbon trading; ▪ encouragement of further investment in relevant R&D;

2 Balance of tax on labour, capital & consumption; environmental taxes

Balance of taxation

2.1 The contribution to Australia's tax revenue from the taxation of capital income is one of the highest compared to other OECD countries. In view of the stated goals of Australia's tax system of efficiency and competitiveness, this factor is undesirable.

2.2 Capital, particularly foreign investment capital, tends to be highly mobile in comparison to labour and consumption, which means that the heavy taxation of capital can easily result in a loss of foreign investment. It is necessary in an increasingly globalised world to attract more foreign investors together with encouraging investment and saving from small businesses and individuals.

2.3 We make the following proposals to counteract Australia's excessive reliance on taxation of capital income:

2.3.1 lowering the corporate tax rate, with any loss of revenue being compensated by a resultant expansion of the tax base as more foreign investment is attracted to Australia;

2.3.2 introduction of a reduction to company tax where the profits of an Australian resident company are reinvested, ie if there is no distribution of dividends during the relevant financial year, in order to encourage Australian resident companies to reinvest rather than distribute profits;

2.3.3 elimination of CGT for entrepreneurs and small businesses in order to encourage small businesses and enterprise, as small businesses are the engines of the economy. In particular, the small business concessions and exemptions should simply be abolished in favour of an outright exemption from CGT for all small businesses and entrepreneurs; and

2.3.4 an election for all CGT assets to be marked to market. This would encourage greater trade in CGT assets, rather than the hoarding of assets to prevent taxation from applying.

2.4 A further key challenge for Australia's future tax system is our ageing population. It is important to encourage people not to cease working and to find full time jobs. Therefore, we make the following proposals:

2.4.1 the use of tax incentives to encourage full time work, for example, lower tax rates for individuals over a particular age; and

2.4.2 the use of tax incentives to encourage workers to find work. For example, tax breaks in the initial year an individual finds a job.

2.5 As for the taxation of consumption, we propose that the Government increase taxation of "unhealthy" commodities (eg alcohol and cigarettes) and to compensate the extra revenues derived from this source with GST-free status for environmentally friendly products, including certain types of vehicles, bicycles and public transport.

Role to be played by environmental taxes

2.6 The recent debate over the imposition of the carbon-trading scheme suggests the possibility that other environmental taxes may be used to reduce damage to the environment. In particular, the Government can develop new taxes on activities that cause damage to the environment in order to discourage corporations from conducting business in such a way.

2.7 We propose that, in particular energy sectors, the Government should commit to introducing a new tax policy based on "give and take" relationships. Briefly, companies would be invited to invest more money into researching the possibilities of providing less polluting products, in exchange for which they will be given tax concessions on their profits.

2.8 Rather than increasing taxation for polluting businesses, it would be wiser to use tax concessions to encourage companies to invest in new energy technologies. We propose that the Government introduce company tax concessions or exemptions for the income derived by any company utilising new energy technologies. Relief may also take the form of greater depreciation deductions for assets of environmentally friendly businesses, or a accelerated deductions (much like the R&D scheme) for researching into less polluting means of production.

2.9 Further, the additional tax revenue raised could be utilised to compensate those affected by environmental damage, as suggested in the Architecture Paper.

2.10 We also propose the following system, which is in use in Europe:

2.10.1 the money derived from additional tax would finance a refundable tax credit given to purchasers of clean vehicles (i.e. advanced technology vehicles);

2.10.2 the Government could encourage car manufacturers to create a list of their top ten efficient cars, through a CO_2 emissions test; and

2.10.3 the system might further be spread as widely as possible to providing tax credits for the purchase of public transport tickets and bicycles.

3 Tax and transfer system for individuals, working families and retirees

Inefficiencies of overlapping

3.1 The diversity of available transfers and of organisations in charge of payment of transfers leads to inefficiencies. Narrowing the criteria to be an eligible transfer recipient would result in increasing controls and decrease overlapping problems.

3.2 Reducing the number of organisations in charge of receiving tax revenues and making transfer payments would result in a significant decrease in administrative costs. In addition, centralisation of tax administration and transfer distribution could help to reduce compliance costs for taxpayers, by taxpayers having only one organisation to contact and a single form to submit.

Adequacy of transfers

3.3 The allocation of transfers should be improved as well, in order to find a good balance between assistance to taxpayers and the need to work. The creation of a centralised entity overseeing the transfer system will assist in this goal.

3.4 We recommend the indexation of the transfer level with the CPI, in order to help to guarantee the adequacy of assistance through transfers as time goes by. Further, tax rates should also be indexed to the CPI to ensure that they reflect inflationary pressures and reducing the need for Governments to engage in ongoing tax cuts.

Churning effect

3.5 The so-called “churning” effect and its associated costs could be reduced by ensuring that all transfers are provided in monthly payments instead of fortnightly. It is advisable to set up a system of monthly compensation between transfers and withheld tax for relevant wage-earners, in order to reduce the number of cash transfers and to optimise costs.

3.6 A compensatory system could also be set up, based on a monthly self assessment statement, under taxpayers' own responsibility. An annual reconciliation of the transfers provided and tax paid could then be undertaken at year end.

Restructuring of tax system

3.7 The tax system should be structured so as to provide a better system for providing financial rewards for working, particularly in light of the ageing population. Any attempt at optimising the effective tax rate should bear in mind the need to encourage older generations to continue to work and at the same time the need to increase the system's efficiency.

3.8 We submit that tax rates could vary depending on the age of the taxpayer. Such a system could help young workers starting out in their careers and/or provide an incentive for persons over 60 to work. For example, taxpayers over 60 could receive a lower tax rate or tax concessions. Alternatively, the thresholds applicable to people of different ages may be different.

4 Taxation of savings, assets and investments

Carry back provision

4.1 Countries such as the United States, the United Kingdom and Canada allow losses and expenditure of some companies to flow through to investors. This is a way to improve loss utilization by allowing losses to be "carried back" to profits of previous years. The "carry back" provisions usually apply to profits generated between one and three years previously.

4.2 Currently in Australia, only a partnership structure allows investment losses to pass through to the taxable income of the investing partners. Tax losses in companies are trapped in the company and only carry forward at company level. This limits the attractiveness of the corporation as an investment vehicle.

4.3 We propose that a form of "carry back" provision be introduced in Australia as a means of encouraging capital investment. The provision however, should limit the amount of losses which can be "carried back", in order not to over-encourage companies in making risky investments.

Reduction in company tax rate

4.4 Non-residents represent 32% of the shareholders in Australian resident companies. Injection of capital from foreign investors increases the productivity and wages of Australian workers. It is important to encourage actively the growth of foreign investments in Australia.

4.5 We propose a reduction in the rate of company tax in Australia, in order to encourage further foreign investment. The imputation system currently in place should, however, be retained so as to continue to encourage domestic investment. The reduction would appear at first to result in a net loss of revenue; however, because foreign investment would be encouraged, the tax base would broaden to counteract this effect, while Australia received the benefits of having more investment.

Interest on savings

4.6 Given the volatility of the current global share market, it is desirable to encourage resident taxpayers to deposit their salary/wages into savings rather than towards investments. There is currently less incentive that there could be to put money into bank savings due to the low rate of return on interest after factoring in inflation and tax. Therefore, we propose that tax concessions be applied to the taxation of interest derived on savings

Taxation of superannuation funds

4.7 All forms of taxation on superannuation funds should be abolished. As a result of Australia's ageing population and to encourage greater savings for people's retirement, superannuation savings should not be taxed at all.

5 State taxes

Transaction taxes

5.1 Taxes imposed by the States tend to be transaction based. Many existing transaction taxes are inefficient and add an unnecessary compliance burden. In addition, the taxation of transfers tends to discourage the turnover of assets, goods and services, with various negative economic effects. Accordingly, inefficient State transaction taxes should simply be abolished by the States.

Excessive diversity of tax policies

5.2 The differing tax policies between the States leads to increased competition to attract taxpayers, which can result in unproductive and unnecessary complexity. Moreover, this diversity in rates, thresholds and ranges of exemptions results in a greater compliance burden for those taxpayers least able to afford advice.

5.3 Accordingly, a greater harmonisation of definitions and bases of the various State taxes could be beneficial to the tax system. At the same time, competitiveness would be kept through retention of the variety of rates and thresholds applicable in each State.

Centralisation

5.4 Complexity and higher compliance costs also arise from a lack of centralisation. The burden could be greatly reduced by placing a single central body in charge of the administration of all State taxes, particularly payroll tax, which could actually be administered at the federal level.

5.5 Actual tax *payments* would be still distributed to the States in order for them to retain their revenues.

6 Tax administration

Administration of tax system

6.1 Increasing globalisation, e-commerce and financial innovation have been driving factors for complexity in the tax system. For effective tax administration a balance between complexity, equity and efficiency needs to be derived. Below, are some suggestions on how best to achieve this balance.

Low revenue generating tax

6.2 We propose the abolition of taxes that yield low revenue and create higher compliance costs for businesses. This particular reform should be aimed at small businesses, which according to the Henry Review incur half of all compliance costs while only contributing 13% of the business tax revenue. In fact, it may be worth considering reducing the tax rate for all small businesses.

Business reporting portal

6.3 We support present proposals to create a single business reporting portal, through which businesses can provide information simultaneously to all levels of government (Federal and State). Although there is an initial cost of creating a business portal, the subsequent reduction in cost of administration for businesses should outweigh the initial cost incurred.

Centralised collection of taxes

6.4 We also propose a more centralised administration and collection of taxes. For example, the Federal Government should handle the administration and collection of all or most State and local government taxes and subsequently redistribute the relevant amounts to States and local governments. Alternatively, such a system should apply at least to business-related taxes.

6.5 Either action would significantly reduce the administration costs involved in the operation of the tax system. This however, would require a certain level of intergovernmental co-operation and agreement

Annual business activity statements

6.6 All small businesses should be given the option of doing their GST and/or other reporting on an annual basis as opposed to on a quarterly basis. Or, alternatively, small business employers should not be required to PAYG withhold and make superannuation contributions with respect to employees. Instead, the burden of tax remittance should be the responsibility of the employee.

7 Interrelationship between tax systems & emissions trading system

Households hit at two levels

7.1 With one in two adult Australians holding shares it is highly likely that many of them will be affected on two levels as a result of the carbon pollution reduction scheme:

- 7.1.1 the general cost increase in goods and services provided by affected industries whose own costs have increased;
- 7.1.2 as a result of price increase in goods and services, consumers will tend to seek alternative and cheaper substitutable goods; and
- 7.1.3 as a result of the transfer of demand the profits of the affected companies will be reduced and hence, shareholders will receive smaller dividends.

7.2 The Government proposes to mitigate as best it can the increase in costs of the affected industries and has indicated that it will assist low to medium income families. Whilst the Government addresses these two key issues, it has not addressed nor mentioned how the effects of decreased dividends, followed by a drop in share prices of affected companies, will impact households, industry and the general economy given the current global economic turmoil.

7.3 We accept it would be contrary to Australia's *laissez faire* share market for the Government to intervene and thus we propose that the Government:

7.3.1 assist low to medium income households not only for the increase in price of goods and services but also for the decrease in dividend income and loss of capital for the hundreds of thousands of adult Australians holding shares in affected companies; and

7.3.2 make contingency plans in case any of the smaller affected companies cease to be a "going concern". For example, a bailout fund should be established to secure both the shareholders and employees of small-medium affected companies.

Tax treatment of financial instruments

7.4 Given the recent and ongoing financial crisis Australia and the rest of the world is experiencing it would be wise to investigate thoroughly how financial instruments will be treated once carbon permits are introduced. As yet, the Government has not indicated how it plans to tax derivative instruments and how the secondary and futures market will be regulated.

7.5 To prevent any further uncertainty we propose that the Government creates a set of stringent rules regulating the use of financial instruments in the secondary market. This will be particularly important when the time comes to integrate Australia's carbon permit market with that of the rest of the world.

Fuel excise

7.6 The Government has indicated that it will reduce its fuel excise on a cent-for-cent basis commensurate with any increase in fuel prices that result as a consequence of the carbon trading scheme. We propose that while this idea could assist with households' disposable incomes, it undermines the basic purpose of the scheme to benefit the environment.

7.7 The carbon pollution reduction scheme has been implemented to reduce Australia's carbon emissions, as they are adversely affecting the environment. However, by effectively subsidising petrol consumption, the Government will be indirectly maintaining Australia's present level of car emissions.

7.8 Whilst the reduction of fuel excise will greatly assist households, it will not change the inevitable rising price of fuel in the long run. By focussing on the short term, the Government will neglect the environment if it effectively subsidises rising fuel costs.

7.9 We propose that a greater part of the revenues received from carbon permits should be used as grants in research and development companies to promote alternative energy innovations. This will be a long term goal that is more likely to benefit the environment and reduce the cost of fuel and/or fuel alternatives in the future.

7.10 Also, investment into better public transport system, the encouragement of cycling and other energy efficient methods of transportation would go some way to reducing carbon emissions. Providing greater tax incentives for the uses of such forms of transport, over for example car usage, would be greatly beneficial. FBT exemptions could apply to public transport benefits and the provision of bicycles.

7.11 Alternatively, tax deductions could be available for individuals who keep a diary of usage of environmentally friendly products, undertake environmentally friendly activities (ie walk to work, rather than drive to work) etc. Traditional tax thinking in this area is simply ineffective to deal with the challenges that climate change will present. Rather than tying deductibility to income generation, it is best to link deductibility of goods and services to environmentally friendly activities and initiatives. In an era of climate change, it is odd that a tax deduction can be claimed if you drive to see a client, but if you walk to see the same client no such tax deduction will be available.

If you have any queries, or wish to discuss, please contact me on 9264 3366.

Regards

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