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17 October 2008

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: AFTSubmissions@treasury.gov.au

Dear Sir/ Madam

Submission to Australia's Future Tax System Review

CPA Australia represents the diverse interests of more than 117,000 finance, accounting and business advisers both in Australia and around the world. We welcome the opportunity to again provide further input into the future of Australia's tax and transfer system.

We also acknowledge and commend the efforts of the Australian Treasury, in collaboration with the Department of Families, Housing, Community Services and Indigenous Affairs, the Department of Employment, Education and Workplace Relations and the Australian Taxation Office, in producing the *Architecture of Australia's tax and transfer system* paper as a backgrounder to this review. We believe this comprehensive publication will contribute to a much better review outcome.

As requested by the Review Panel, our organisation's submission considers the framing questions raised, viz:

- What major challenges facing Australia need to be addressed through the tax-transfer system?
- What features should the system have in order to respond to these challenges?
- What are the problems with the current system?, and
- What reforms do we need to address these problems?

The major part of the submission focuses on the fourth question above, that is, the reforms deemed appropriate to address the problems, and we make recommendations where possible.

Please find enclosed our submission to the review. If you have any questions regarding this submission, please contact Garry Addison FCPA - Senior Tax Counsel on (03) 9606 9771, or via email: garry.addison@cpaaustralia.com.au.

Yours faithfully

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Enc

CPA Australia

Australia's Future Tax System

Submission

17 October 2008

Summary

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As requested by the Review Panel, our organisation's submission considers the framing questions raised, viz:

- What major challenges facing Australia need to be addressed through the tax-transfer system?
- What features should the system have in order to respond to these challenges?
- What are the problems with the current system?, and
- What reforms do we need to address these problems?

The majority of the submission focuses on the fourth question above, that is, the reforms deemed appropriate to address the problems, and we make recommendations where possible.

1. Major challenges

We consider the major challenges to be as follows:

- the need for sustainable economic growth, as identified in our submission to the Australian Government's 2020 Summit in April this year
- climate change and the proposed carbon pollution reduction scheme (CPSR)
- need for Australia to be internationally competitive in an increasingly globalised world
- demographic challenges of an ageing population and the need to address this via measures to enhance participation and productivity
- issues in Commonwealth/State relations, particularly the need for joint action to remove inefficient state taxes
- interrelationship between the age pension, the superannuation system and the role of voluntary savings in the context of Australia's retirement income policy, and
- need to avoid undue complexity in the current tax/transfer system.

2. Necessary features of a modern tax-transfer system to cope with the above challenges

The major design features of a modern tax system for Australia should be as follows:

- the design of the tax system should result in a robust and stable revenue base

- the tax system should support Australia's international competitiveness and support a growing and vibrant business sector, and minimise the tax administration burden on all businesses
- the tax-transfer system should, to the maximum extent possible, be consistent with broader government policy objectives in areas such as climate change, the emissions trading system, population policy, globalisation and technological change
- the design of the tax-transfer system should endeavour to minimise distortionary effects on behaviour, including workforce participation, rates of saving, and engagement in entrepreneurial and commercial activities. It should also be consistent with the traditional principles of equity, simplicity (or eliminating unnecessary complexity) and efficiency
- where the design of the tax-transfer system involves making trade-offs between competing policy objectives, this should be done in an open and transparent way, and
- the design of the tax-transfer system should be flexible so that it can adapt to changing domestic and international circumstances.
- to the maximum extent possible, the most inefficient of taxes levied by the commonwealth, state, territory and local governments should be removed
- the current imbalances between the spending responsibilities and revenue raising powers of the Commonwealth and the states (VFI) should be addressed in a way that is simple, transparent and provides sufficient certainty for both levels of government, and
- appropriate incentives should be given to the states to improve efficiencies in service delivery, ease compliance burdens and duplication of effort for taxpayers and to remove inefficient taxes.

3. Problems with the current system

CPA Australia considers that the major problems with the current system are as follows:

- the excessive taxation of capital income vis-à-vis other OECD countries, including particularly the over-reliance on revenue from company taxation
- Australia's lower share of tax revenue from labour income and our lesser reliance on consumption taxes (particularly broad-based consumption taxes) than other OECD countries
- complexity of the Australian tax system as reflected both in the policy and legislation areas and exacerbated by the excessive number of inefficient taxes levied across the various (Commonwealth/state/local government) taxing jurisdictions
- lack of neutrality in the tax treatment of capital income due to variations arising from the particular structure/vehicle through which the income is derived (including different types of company, trust and partnership, etc structures) and the tax status of the ultimate recipient
- gross imbalance (VFI) between Commonwealth and state spending and taxing powers and the large number of inefficient taxes at the state level including variations between the states in respect to such taxes and their administration
- complexity of Australia's current arrangements for the taxation of international transactions involving both residents and non-residents

- the complexity of Australia's transfer system due to the wide range of benefits available and the nature of their interaction with the tax system including the provision of 'welfare' type benefits through the tax system and the high effective marginal tax rates (EMTRs) applicable to many transfer recipients, and
- the use of the tax system for purposes other than raising revenue such as to pursue social policy, industry assistance and/or environmental objectives.

4. Proposed reforms

CPA Australia recommends that the following reforms be implemented in a timely basis to enhance the equity, efficiency and simplicity of the Australian tax/transfer system in the context of the major challenges faced by the system in the years ahead:

Recommendation 4.1

CPA Australia recommends that the Government:

- continue with its personal tax reform program with a particular emphasis on addressing the EMTR problem
- remove the Medicare Levy and fund any revenue shortfall with increases in other Commonwealth taxes
- request the Board of Taxation to undertake a major rewrite of the current FBT legislation to achieve considerable simplification of the law, and
- remove all welfare benefits from the tax system and channel such payments through the social security system via Centrelink to the extent possible.

Recommendation 4.2

The existing over-taxation of capital income vis-à-vis other comparable OECD countries should be addressed by considering taxing such income at a flat rate of 30% (unless a taxpayer faces a lower marginal tax rate or derives income via a superannuation fund or another concessionally taxed vehicle) and also by a range of business tax reforms including:

- a reduction in the existing company tax rate from 30% to 25%
- providing a deduction for impaired purchased goodwill
- introducing tax rules allowing a limited carry-back of tax losses, and
- providing Australian investors a 20% tax credit on any unfranked dividend sourced from taxable offshore profits.

Recommendation 4.3

The terms of reference for the review regarding the GST, as well as the far reaching potential difficulties are acknowledged. However we also note that this is an issue that will need to be considered at some time in the future.

Recommendation 4.4.1

Possible tax measures for consideration to encourage appropriate behavioural change regarding reducing emissions include:

- higher Research and Development (R&D) tax concession of 200% or an equivalent value tax credit (fully refundable) for R&D into new or improved low emissions and carbon capture and storage technology.
- accelerated depreciation for capital expenditure on replacing or upgrading existing plant and equipment with lower emissions technology.
- upfront investment allowance of 20% for capital expenditure on low emissions technology.
- the recommendation contained within the OECD's Environmental Performance Review of Australia 2007 that congestion and road pricing, fuel and vehicle taxation and parking charges could reduce emissions from transportation.

Recommendation 4.4.2

As part of process of designing a suite of measures to bring about behavioural change and a reduction in carbon emissions the following should also be considered/ reviewed:

- the concessional treatment of car fringe benefits under the statutory formula method in the fringe benefits tax (FBT) legislation where FBT liability falls as total kilometres travelled increases
- whether abatement activities such as the voluntary purchase of carbon offsets would be deductible under the general deductibility provision of section 25-1
- if abatement activity is not deductible under the general provisions, whether section 40-880 of the Income Tax Assessment Act 1997 covering blackhole expenditure would apply
- clarify whether activities directed at preventing and remedying general pollution from carbon emissions are deductible under section 40-755, and
- ensure indirect taxes (the GST, excise and stamp duty) do not contain disincentives to abatement activity.

Recommendations: 4.5.1

- Increase the SGC (say to between 12 to 15 per cent) to ensure that those earning below average earnings and/or with broken work patterns are able to maintain a reasonable standard of living in retirement.

- If any increase in the SGC is ruled out, appropriate changes should be made to increase voluntary contributions and/or the effectiveness of existing contributions.

Recommendations: 4.5.2

- Remove contributions tax on a fixed dollar amount of concessional contributions.
- Extend compulsory superannuation to the self employed.

Recommendations: 4.5.3

- Align the top threshold of the co-contribution scheme with the cut-off for the 30 per cent marginal tax bracket.
- Extend the co-contribution scheme to individuals outside of the paid workforce.

Recommendation: 4.5.4

The SG earnings threshold of $450 per month to be replaced with a one month only threshold of $450.

Recommendation: 4.5.5

Introduce a 3 per cent voluntary superannuation contribution scheme.

Recommendation: 4.5.6

Abolish the '10 per cent rule' for the deductibility of superannuation contributions to provide greater incentive and flexibility to people who have to make their own superannuation provisions.

Recommendation: 4.5.7

The tax treatment of superannuation death benefits to be reviewed to ensure consistent and equitable treatment of payments to dependants and non-dependants alike.

Recommendation 4.6

CPA Australia recommends that further reform of the remaining inefficient state/territory taxes be addressed by the Commonwealth and the states in the context of the current review and the COAG process as appropriate.

Recommendation 4.7

CPA Australia recommends that further consideration be given to the role of broad-based indirect taxes in Australia's overall tax mix in the light of our proposed reforms.

Recommendation 4.8

CPA Australia strongly supports the current and proposed measures being pursued by the government in the area of cross border transactions and looks forward to their early completion.

Recommendation 4.9

CPA Australia recommends that appropriate measures be implemented to minimise the complexity of the Australian tax system including the measures flagged above.

Introduction

CPA Australia represents the diverse interests of more than 117,000 finance, accounting and business advisers both in Australia and around the world. We welcome the opportunity to again provide further input into the reform of Australia's tax and transfer system.

Further, we also acknowledge and commend the efforts of the Australian Treasury, in collaboration with the Department of Families, Housing, Community Services and Indigenous Affairs, the Department of Employment, Education and Workplace Relations and the Australian Taxation Office, in producing the *Architecture of Australia's tax and transfer system* paper as a backgrounder to this review. We believe this work will contribute to a much better review outcome.

Our submission considers the framing questions raised by the Review Panel, viz:

- What major challenges facing Australia need to be addressed through the tax-transfer system?
- What features should the system have in order to respond to these challenges?
- What are the problems with the current system?, and
- What reforms do we need to address these problems?

The majority of the submission focuses on the reforms deemed appropriate to address the problems identified in the current tax/ transfer system.

1. Major challenges

We consider the major challenges to be as follows:

- sustainable economic growth in a global economy, as identified out in our earlier 2020 Summit submission (April 2008)
- climate change and the proposed carbon pollution reduction scheme (CPSR)
- need for Australia to be internationally competitive in an increasingly globalised world
- demographic challenges of an aging population and the need to address this via measures to enhance participation and productivity
- issues in Commonwealth/State relations, particularly the need for joint action to remove inefficient state taxes
- interrelationship between the age pension, the superannuation system and the role of voluntary savings in the context of Australia's retirement income policy, and
- need to avoid undue complexity in the current tax/transfer system.

2. Necessary features of a modern tax-transfer system to cope with the above challenges

As noted by the Business Coalition for Tax Reform (BCTR) the major design features should be as follows:

- the design of the tax system should result in a robust and stable revenue base
- the tax system should support Australia's international competitiveness and support a growing and vibrant business sector, and minimise the tax administration burden on all businesses
- the tax-transfer system should, to the maximum extent possible, be consistent with broader government policy objectives in areas such as climate change, the emissions trading system, population policy, globalisation and technological change
- the design of the tax-transfer system should endeavour to minimise distortionary effects on behaviour, including workforce participation, rates of saving, and engagement in entrepreneurial and commercial activities. It should also be consistent with the traditional principles of equity, simplicity (or eliminating unnecessary complexity) and efficiency
- where the design of the tax-transfer system involves making trade-offs between competing policy objectives, this should be done in an open and transparent way, and
- the design of the tax-transfer system should be flexible so that it can adapt to changing domestic and international circumstances
- to the maximum extent possible, the most inefficient of taxes levied by the commonwealth, state, territory and local governments should be removed
- the current imbalances between the spending responsibilities and revenue raising powers of the Commonwealth and the states (VFI) should be addressed in a way that is simple, transparent and provides sufficient certainty for both levels of government, and
- appropriate incentives should be given to the states to improve efficiencies in service delivery, ease compliance burdens and duplication of effort for taxpayers and to remove inefficient taxes.

3. Problems with the current system

CPA Australia considers that the major problems with the current system, as identified in the Treasury Architecture Paper, are as follows:

- the excessive taxation of capital income vis-à-vis other OECD countries, including particularly the over-reliance on revenue from company taxation
- Australia's lower share of tax revenue from labour income and our lesser reliance on consumption taxes (particularly broad-based consumption taxes) than other OECD countries
- complexity of the Australian tax system as reflected both in the policy and legislation areas and exacerbated by the excessive number of inefficient taxes levied across the various (Commonwealth/state/local government) taxing jurisdictions
- lack of neutrality in the tax treatment of capital income due to variations arising from the particular structure/vehicle through which the income is derived (including different types of company, trust and partnership, etc structures) and the tax status of the ultimate recipient
- gross imbalance (VFI) between Commonwealth and state spending and taxing powers and the large number of inefficient taxes at the state level including variations between the states in respect to such taxes and their administration
- complexity of Australia's current arrangements for the taxation of international transactions involving both residents and non-residents
- the complexity of Australia's transfer system due to the wide range of benefits available and the nature of their interaction with the tax system including the provision of 'welfare' type benefits through the tax system and the high effective marginal tax rates (EMTRs) applicable to many transfer recipients, and
- the use of the tax system for purposes other than raising revenue such as to pursue social policy, industry assistance and/or environmental objectives.

4. Proposed reforms

In view of the range of problems with the current tax system, it is clearly not possible, in our view, for all of them to be addressed at once. Some of the changes required may also impact on revenue collections. Notwithstanding the challenges this presents, the following is an outline of our initial views on proposed reforms to Australia's tax and transfer system.

The topics covered comprise the following:

- taxation of labour income
- taxation of income from capital (or capital income as discussed in the Treasury paper)
- consumption taxes
- climate change/carbon pollution reduction scheme (CPRS)/complementary measures
- state taxes
- tax mix/funding issues
- taxation of cross-border investments, and
- tax complexity

4.1 Taxation of labour income

Australia's lower share of tax revenue from labour income appears to be due to a combination of the following factors

- significant cuts in personal income tax arising from the introduction of the GST in July 2000
- further cuts in income tax implemented by the former government since 2003 arising from the increased revenues accruing to Australia via the resources boom
- the fact that Australia is only one of two countries that do not impose social security taxes on labour income, and
- state pay-roll taxes address this imbalance to some extent but these revenues are significantly reduced by small business exemptions.

This trend appears set to continue due to further personal income tax cuts in 2008/09 and the following two years as announced in the recent Federal Budget with a more aspirational rate scale to apply from 1 July 2013.

As you will be aware, CPA Australia has been a strong advocate of reform in this area for many years, and we therefore welcome the Government's proposed changes to the personal income tax rate scale as announced in the 2008/09 Federal Budget including the aspirational scale (of 15%, 30% and 40% and enhanced low income rebate to replace the current zero rate threshold) to apply from 2013/14.

It would now seem appropriate, however, to review the operation of the Medicare Levy, particularly given that the levy funds less than 20% of the Commonwealth's total health expenditure and thus cannot be seriously considered as a properly functioning hypothecated tax. Unless the levy can be increased to better reflect the true cost of Commonwealth health services, it should be incorporated directly into the existing personal income tax rate scale, or preferably, funded by an appropriate increase in indirect taxes.

As well as reducing the tax distortions arising from high personal tax rates, the changes should also ameliorate the impact of the high effective marginal tax rates (EMTRs) applicable to many lower income earners arising out of the interaction of personal tax rates and the means testing arrangements in the social security system. Notwithstanding these changes, we believe that more remains to be done to further address the EMTR problem given its adverse impact on worker participation rates particularly in the context of an ageing population.

The other concern in relation to the personal tax/transfer system interaction is the extent to which the tax system has been used in recent years to provide welfare type benefits and other similar assistance to taxpayers. We do not favour this approach as it simply introduces greater complexity into the tax system and simply increases the already heavy workload of tax agents who, for various reasons, experience difficulties in dealing with Centrelink and social security matters generally.

We believe it is imperative that the current review of the tax-transfer system should be aimed at removing all social welfare benefits (including the so-called family tax benefits) from the tax system and replacing them (if necessary) with appropriate outlays and channelling them through the social security system. It would also seem desirable for the review to consider a rationalisation of the existing plethora of different benefits with a view to reducing complexity and facilitating access to benefits by the intended low income recipients.

While means testing of benefits gives rise to increased complexity as compared to the wider access available in most other OECD countries, we accept that the Australian model does result in significantly less ‘churn’ than is the case elsewhere as is reflected in Australia’s much lower tax/GDP vis-à-vis these other countries.

We do not support a move to a family unit basis of taxation for the following reasons:

- the greater complexity associated with this basis of taxation relative to one based on the individual
- its tendency to reduce work incentives for secondary earners at a time when we clearly need to enhance work incentives for all taxpayers, and
- the trend in recent years for many OECD countries to move away from family based taxation.

While we note that most OECD countries tax fringe benefits in the hands of the recipient as part of their personal tax systems, CPA Australia does not support this approach for Australia.

That said, however, we believe that priority should be given to a major rewrite of the current FBT legislation with a view to achieving considerable abbreviation and simplification of the current law. This review could be undertaken by the Board of Taxation and could effectively be along the lines of the Board’s current review of the legal framework for the GST.

The main focus of the proposed rewrite should be on the following:

- place all relevant definitions in one section (e.g. section 136) of the current Act
- when terms are given a meaning rather than being defined, treat them as definitions and put them in section 136 as well
- each subdivision A of the current Act indicates what the benefit is and then each subdivision B determines its taxable value. We believe that the 13 or so subdivision Bs should be consolidated into one single subdivision and rewritten, as they are currently largely repetitious but all are nearly incomprehensible
- the remote area and relocation rules are many and complex and the differences between each rule add unnecessarily to the complexity of the law and lack any clear justification, and

- the taxable amount and reporting rules (sections 5 and 135 respectively) are poorly drafted and difficult to understand and thus need to be rewritten to make them comprehensible.

Recommendation 4.1

CPA Australia recommends that the Government:

- ***continue with its personal tax reform program with a particular emphasis on addressing the EMTR problem***
- ***remove the Medicare Levy and fund any revenue shortfall with increases in other Commonwealth taxes***
- ***request the Board of Taxation to undertake a major rewrite of the current FBT legislation to achieve considerable simplification of the law, and***
- ***remove all welfare benefits from the tax system and channel such payments through the social security system via Centrelink to the extent possible.***

4.2 Taxation of capital income

CPA Australia is strongly of the view that the current dividend imputation scheme should be retained for the following reasons:

- it removes the ‘double’ taxation of dividends that arises under the ‘classical’ system of company taxation, and
- as noted in the Treasury ‘Architecture’ paper, it also achieves neutrality of treatment between debt and equity.

While other options may also be available to improve the debt/equity neutrality, we note that such systems do not appear as effective as dividend imputation in this regard and have to date been confined to a very small number of OECD and non-OECD countries such as Belgium, Brazil and Estonia.

Australia’s current over-taxation of income from capital has both a domestic and international component since company tax operates as a final tax for non-residents on the returns from their equity investments in Australia but only as a withholding tax for resident taxpayers on similar investments.

CPA Australia believes, therefore that the most appropriate way to overcome the current over-taxation of capital income in respect to both residents and non-residents would be to implement the following reforms:

- reduce the existing company tax rate from 30% to 25%
- remove existing anomalies in the business/corporate tax base that have been previously identified in the 3 April 2006 report by the former government on the ‘International Comparison of Australia’s Taxes’, and
- introduce a maximum flat rate of tax on capital income derived by Australian residents of 30% with a lower (or nil rate) applicable to those taxpayers facing a marginal tax rate on their capital income of less than 30%.

This approach would significantly enhance the international competitiveness of Australia’s company tax regime while at the same time also reducing the tax burden on dividends received by Australia residents on the returns from their Australian equity investments. It should be noted, of course, that a reduction in the company tax rate by itself would be of limited benefit to Australian residents since they would still be taxed on their dividend income at their relevant marginal tax rate.

The proposed 30% flat rate on capital income would apply to all income from capital including interest, dividends and rent but not capital gains which would continue to be taxed under the existing discount system. This approach would still provide more neutral treatment of capital income than exists at present.

The proposed 30% flat tax on capital income may also need to be accompanied by rules to ensure that deductions incurred in earning such income be only claimed at the 30% rate to discourage excessive gearing of relevant investments, etc.

The current major anomalies in the corporate tax base that need to be addressed include:

- the absence of any deduction for impairment of purchased goodwill. We consider a tax deduction should be allowed to the extent the value of goodwill becomes ‘impaired’ consistent with the expense treatment allowed under accounting standards and with the approach adopted by the major OECD countries including the USA and UK;

- the lack of tax rules allowing the carry-back of tax losses. Companies should be allowed to carry-back tax losses for a limited period of between one to three years to offset against taxable income consistent with the loss recoupment policies of other major OECD countries;
- the effective double taxation of taxed offshore profits when distributed by an Australian resident company to an Australian resident shareholder. The current imputation regime does not provide any tax relief for dividends sourced from offshore taxed profits paid to an Australian resident shareholder via an interposed Australian company. This anomaly creates an unintended bias against investment in offshore companies by Australian resident companies as resident shareholders are ultimately disadvantaged as they will not receive any franking credits on such foreign sourced dividends. This problem can be ameliorated by implementing a 2003 Board of Taxation recommendation that such shareholders receive a 20% tax credit on any unfranked dividends paid out of taxed offshore profits.

Recommendation 4.2

The existing over-taxation of capital income vis-à-vis other comparable OECD countries should be addressed by considering taxing such income at a flat rate of 30% (unless a taxpayer faces a lower marginal tax rate or derives income via a superannuation fund or another concessionally taxed vehicle) and also by a range of business tax reforms including:

- ***a reduction in the existing company tax rate from 30% to 25%***
- ***providing a deduction for impaired purchased goodwill***
- ***introducing tax rules allowing a limited carry-back of tax losses, and***
- ***providing Australian investors a 20% tax credit on any unfranked dividend sourced from taxable offshore profits.***

4.3 Consumption taxes

Given that any changes to the GST rate and base have been ruled our for purposes of the current review, there would not appear to be much, if any, scope for Australia to increase its reliance on broad based consumption taxes in the near future.

Recommendation 4.3

The terms of reference for the review regarding the GST, as well as the far reaching potential difficulties are acknowledged. However we also note that this is an issue that will need to be considered at some time in the future.

4.4 Climate change/Carbon Pollution Reduction Scheme (CPRS) - Complementary measures

Given the target set by the government to reduce Australia's greenhouse gas emissions by 2050 and the coverage of the proposed Carbon Pollution Reduction Scheme - the CPRS (the Green Paper estimates that 1,000 entities will have direct obligations under the scheme and cover some 70% of Australia's emissions), complementary policy options, including tax and other fiscal incentives accessible by all businesses are required as part of a package response to climate change.

These complementary policy options should be available to all businesses, particularly small to medium sized business who will not be directly liable under the CPRS and:

- they should encourage the deployment of existing technology that reduces emissions and energy use (early action)
- encourage investment in developing and early commercialisation of new technology, and
- assist business to better understand their impact on the environment.

Any additional reduction in greenhouse gas emissions that complementary measures can achieve from businesses not covered by the CPRS, will lead to lower emission permit prices in the long-term. If the CPRS only covers 70% of emissions, then without incentives to change behaviour in the remaining 30% of emissions, liable entities under the CPRS would have to bear an increasing burden to achieve the 60% reduction target set by the government, which would be achieved through higher permit prices than should otherwise be necessary.

In addition, it is important to recognise that the price signal from the CPRS may not necessarily be strong enough to encourage behavioural change in many businesses. Therefore, we believe that complementary measures will add to the price signal that the CPRS creates, further encouraging behavioural change, not only in the two million Australian businesses that are not covered by the CPRS but also those 1,000 liable entities in the CPRS. Complementary measures will take on greater importance with liable entities if the final design of the CPRS leads to the price signal being weaker than would cause behavioural change in some liable entities.

Thus, while CPA Australia's general philosophy is that incentives should not typically be provided through the tax system, we believe that the compelling necessity of urgently reducing carbon emissions justifies the inclusion of tax measures to encourage the entire business community to invest in the development and deployment of new or improved low emissions technology. Accordingly, we believe the following tax measures may encourage such behavioural change:

- a higher Research and Development (R&D) tax concession of 200% or an equivalent value tax credit (fully refundable) for R&D into new or improved low emissions and carbon capture and storage technology
- accelerated depreciation for capital expenditure on replacing or upgrading existing plant and equipment with lower emissions technology
- An upfront investment allowance of 20% for capital expenditure on low emissions technology
- the recommendation contained within the OECD's *Environmental Performance Review of Australia 2007* that congestion and road pricing, fuel and vehicle taxation and parking charges could reduce emissions from transportation.

Recommendation 4.4.1

Possible tax measures for consideration to encourage appropriate behavioural change include:

- ***higher Research and Development (R&D) tax concession of 200% or an equivalent value tax credit (fully refundable) for R&D into new or improved low emissions and carbon capture and storage technology.***
- ***accelerated depreciation for capital expenditure on replacing or upgrading existing plant and equipment with lower emissions technology.***
- ***upfront investment allowance of 20% for capital expenditure on low emissions technology.***
- ***the recommendation contained within the OECD's Environmental Performance Review of Australia 2007 that congestion and road pricing, fuel and vehicle taxation and parking charges could reduce emissions from transportation.***

In addition to considering new tax measures or extending existing tax measures, the government should review the impact that current taxation laws have on behaviour. In particular, the following should be reviewed:

- the concessional treatment of car fringe benefits under the statutory formula method in the fringe benefits tax (FBT) legislation where FBT liability falls as total kilometres travelled increases
- whether abatement activities such as the voluntary purchase of carbon offsets by a business would be deductible under the general deductibility provision of section 25-1
- if abatement activity is not deductible under the general provisions, whether section 40-880 of the *Income Tax Assessment Act 1997* covering blackhole expenditure would apply
- clarify whether activities directed at preventing and remedying general pollution from carbon emissions are deductible under section 40-755, and
- ensure indirect taxes (the GST, excise and stamp duty) do not contain disincentives to abatement activity.

Recommendation 4.4.2

As part of process of designing a suite of measures to bring about behavioural change and a reduction in carbon emissions the following should also be considered/ reviewed:

- ***the concessional treatment of car fringe benefits under the statutory formula method in the fringe benefits tax (FBT) legislation where FBT liability falls as total kilometres travelled increases***

- ***whether abatement activities such as the voluntary purchase of carbon offsets would be deductible under the general deductibility provision of section 25-1***
- ***if abatement activity is not deductible under the general provisions, whether section 40-880 of the Income Tax Assessment Act 1997 covering blackhole expenditure would apply***
- ***clarify whether activities directed at preventing and remedying general pollution from carbon emissions are deductible under section 40-755, and***
- ***ensure indirect taxes (the GST, excise and stamp duty) do not contain disincentives to abatement activity.***

4.5 Superannuation and retirement savings

4.5.1 Improving retirement savings

There have been significant improvements to Australia's retirement savings system in recent years. Superannuation is now more accessible, benefit options are more flexible and incentives for increasing retirement savings have improved. The simplified superannuation changes will no doubt improve retirement savings. However, we cannot afford to be complacent.

Modelling conducted by the National Centre for Social and Economic Modelling (NATSEM) for CPA Australia, and contained in the report *Superannuation: The right balance?*[1] shows the 9 per cent compulsory superannuation guarantee will only provide an adequate standard of living in retirement for an individual on average earnings under ideal conditions where individuals enjoy compulsory superannuation contributions for their entire working life and are also in a position to make voluntary savings (see following table).

Family type	Pre-retirement Income level	Replacement Rate (%)
Single Male	Low ($34,339)	92
	Middle ($51,509)	76
	High ($77,264)	64
Single Female	Low	98
	Middle	81
	High	65
Couple (No Children)	Low	82
	Middle	67
	High	57
Couple (2 Children)*	Low	137
	Middle	120
	High	101

[1] NATSEM, CPA Australia, *Superannuation: the right balance?*, 2008.

*Replacement rate appears high as it is being compared to the lower standard of living associated with the cost of raising children. In reality, the living standard in retirement is similar or slightly lower than that for a couple without children.

For those individuals earning below average earnings or with broken work patterns, the SG alone will not be enough. It is recognised that a savings level of 12 to15 per cent is needed to maintain standards of living in retirement.

Further initiatives and policy changes are required if retirement savings levels are to be appropriately increased. This can be achieved by either lifting contribution rates or improving the effectiveness of existing contribution arrangements, or a combination of both.

The government has already stated its commitment to maintaining the compulsory superannuation guarantee at 9 per cent of income. However, an increase in the SG should not be ruled out if it is necessary to boost retirement savings.

If any increase in the SG was ruled out, any increases in contribution levels must come from increased voluntary contributions or government contributions. Increasing the effectiveness of contributions could be achieved by reducing or removing the tax on contributions. These suggestions are explored in more detail below.

Recommendations: 4.5.1

Increase the SGC (say to between 12 to 15 per cent) to ensure that those earning below average earnings and/or with broken work patterns are able to maintain a reasonable standard of living in retirement.

If any increase in the SGC is ruled out, appropriate changes should be made to increase voluntary contributions and/or the effectiveness of existing contributions.

4.5.2 Removal of contributions tax

Low income earners – on the 15% and nil tax brackets – receive no tax benefit for making concessional contributions to superannuation – i.e. SG or salary sacrifice – as these contributions are taxed at 15% and any earnings are taxed at a maximum of 15% in the fund.

Low income earners may actually be better off receiving the extra income in their hand than in compulsory superannuation contributions. While low income earners do qualify for the government co-contribution, they may not have the disposable income available to channel towards superannuation to obtain it.

The 15% tax on the 9% SG contributions means the effective contribution to an individual's superannuation account is only 7.65%. Modelling conducted by NATSEM (see the following table) demonstrates that removing the contributions tax on SG contributions would improve replacement rates by 5 to 6% for low income earners ($34,339), 7 to 9% for average income earners ($51,509) and 9 to 14% for high income earners ($77,264).

Family type	Income level	Replacement Rate (%)	Replacement Rate – nil contributions tax (%)
Single Male	Low ($34,339)	92	97
	Middle ($51,509)	76	82
	High ($77,264)	64	70
Single Female	Low	98	103
	Middle	81	87
	High	65	73
Couple (No Children)	Low	82	87
	Middle	67	73
	High	57	63
Couple (2 Children)	Low	137	145
	Middle	120	130
	High	101	115

The simplest option may be the wholesale removal of the contributions tax on SG contributions. However, we believe it would be more equitable to cap the level of contributions at which the tax is removed, thus directing the benefit towards lower income earners. CPA Australia has considered two options for removing contributions tax, both of which would provide the majority of the tax benefit to individuals on lower income levels:

1. Remove contributions tax on SG contributions based on taxable income. The contributions tax could be removed by providing a rebate to individuals on the 30% marginal tax bracket and below. Mechanisms, such as the co-contribution and first home saver account government contribution, could be duplicated with contributions tax being rebated back to an individual's superannuation account once their eligibility has been determined following lodgement of their income tax return.

2. Remove contributions tax on a specific dollar or percentage amount of concessional contributions that is not linked to income, for example 9% of the maximum SG contribution base (currently $152,720 pa) or $13,745 for the 2008-09 financial year. Funds would be able to exclude the first $13,745 of contributions from contributions tax when they are received. If an individual were to exceed the contributions tax free threshold due to error or multiple funds, the excess could be recovered using the excess tax mechanism introduced as part of the Simpler Superannuation measures.

The disadvantage of the first option is that the incentive is not immediate in that it is provided after the event once an individual's income tax return has been lodged. Also, funds are not always able to identify SG and voluntary employer (i.e. salary sacrifice) contributions as employers are not obliged to report them separately.

The advantages of the second option are that it would provide a more immediate incentive and it is less complex. By including all concessional contributions it would provide a greater benefit to lower income earners and an incentive for them to make additional contributions via salary sacrifice. It would also provide the self employed with a greater incentive to contribute to their superannuation.
However, the concession provided by the removal of the contributions tax should be limited to the accumulation phase to encourage and maximise retirement savings, not the draw down phase.

As such, we suggest the government consider removing the contributions tax on a fixed dollar amount of concessional contributions made by/for individuals prior to them reaching their preservation age. We also suggest the compulsory superannuation be extended to the self employed, whereby they would be required to contribute at least 9% of their income each year to superannuation.

Recommendations: 4.5.2

- ***Remove contributions tax on a fixed dollar amount of concessional contributions.***
- ***Extend compulsory superannuation to the self employed.***

In addition to the reduction of contributions tax, there are a number of other measures to consider to raise contribution levels.

4.5.3 Extending the government co-contribution scheme

The government co-contribution has so far been a great success according to both government reports and anecdotal evidence from superannuation funds. With the increased coverage and more generous benefit, the co-contribution is a very positive incentive. However, it does not provide universal coverage, with individuals out of the workforce unable to access it. For example, parents raising a family, students or the unemployed.

The increases to the marginal tax rates announced in recent federal budgets highlight the gap in incentives for many 'average' income earners subject to the 30 per cent marginal tax rate. While individuals earning less than $60,342 can access the co-contribution and for those earning greater than $80,000, salary sacrifice is tax effective, there are no incentives for those in between to make voluntary contributions. This could be addressed by lifting the co-contribution thresholds to be more aligned with the new marginal tax rates.

Recommendations: 4.5.3

- ***Align the top threshold of the co-contribution scheme with the cut-off for the 30 per cent marginal tax bracket.***
- ***Extend the co-contribution scheme to individuals outside of the paid workforce.***

4.5.4 Abolishing the minimum superannuation guarantee threshold

The superannuation guarantee earnings threshold of $450 per month was introduced when SG commenced at a level of 3 per cent of salary. Since then the SG level has increased to 9 per cent and the workforce has become increasingly casualised.

As a result more people are at risk of being excluded from the SG system and not having access to adequate retirement savings. For example, an individual working two or three casual jobs, each earning just under the $450 threshold each month, could be missing out on SG contributions of $800 to $1200 each year.

To boost retirement savings, particularly for people with broken or casual work patterns, we recommend the SG threshold be abolished. However, we do recognise the administrative burden that may be experienced by employers when meeting their SG and choice of fund obligations for casual or itinerant employees. As such, we would be supportive of any exclusion for one-off or short-term employment situations. One solution would be for employers to only be permitted to apply the $450 threshold once for a single month for an individual employee. That is, generally it would only be utilised in their first month of employment after which if their employment continues, SG should be paid.

Recommendation: 4.5.4

The SG earnings threshold of $450 per month to be replaced with a one month only threshold of $450.

4.5.5 A default scheme for voluntary personal contributions

While not strictly a tax measure, the introduction of an 'opt-out' default scheme for voluntary personal contributions would encourage voluntary superannuation contributions and lead to improved retirement savings.

Voluntary contributions, above the compulsory 9 per cent amount, are one way to fill the gap. The level of voluntary contributions has been falling since the late 1990s. While it is yet to be seen if the introduction of the co-contribution will arrest the decline, one way to encourage voluntary contributions would be to introduce a default scheme whereby voluntary contributions were automatically deducted from an employee's salary unless they chose to 'opt out' of the scheme. Such a scheme could commence at 1 per cent of salary and increase to 3 per cent over three years. Similar schemes operate very successfully overseas.

Recommendation: 4.5.5

Introduce a 3 per cent voluntary superannuation contribution scheme.

Simplification and equity

While the simplified superannuation changes have simplified key aspects of the superannuation system, there still remain particular areas of complexity and inequity that need to be addressed before superannuation can truly be considered simple.

The following initiatives, if implemented, would be a significant step forward in reducing complexity and inequity within the superannuation system, while further improving the adequacy of retirement savings.

4.5.6 Extend deductibility of superannuation contributions

The introduction of the contribution caps under the simplified superannuation changes, particularly the concessional contribution cap, provides the opportunity to remove the inequities that exist around the application of the '10 per cent rule' for claiming a tax deduction for superannuation contributions.

Employment arrangements have become more flexible with many people employed under casual or contracting arrangements. Those who consider themselves largely self-employed have found they may have lost their eligibility to claim a deduction for superannuation contributions after taking on relatively small consulting or contracting roles. There is often a double whammy effect in that these contracting roles will only pay superannuation guarantee (SG) contributions and there is no provision for the contractor to make voluntary or salary sacrifice contributions. The result is individuals may end up with minimal superannuation coverage since they do not have any more than SG coverage from their employment, and they are not able to claim a deduction for their own contributions. These individuals are at a distinct disadvantage compared to those who are full-time employees or full-time self-employed.

Abolishing the 10 per cent rule would allow employees to claim a deduction for their personal superannuation contributions. However, with full deductibility being given to personal contributions, there is essentially no difference between the treatment of employer, salary sacrifice and personal deductible (i.e. self employed) contributions and therefore no rationale as to why such deductibility is not permitted.

The $50,000 annual limit on concessional contributions would control the concessions available and there would be no benefit in exceeding the limit as excessive contributions would be taxed at the top marginal tax rate.

Allowing deductibility for personal contributions would benefit those employees whose employers limit or do not provide for salary sacrifice contributions.

Abolishing the 10 per cent rule would create a level playing field whereby all superannuants would have the same access to concessional contributions and the same flexibility to decide whether their voluntary contributions should be made from before or after tax income. The limits on concessional and non-concessional contributions would ensure everyone receives the same tax concessions. Such a move would be another important step in ensuring equity and simplifying the superannuation system.

Recommendation: 4.5.6

Abolish the '10 per cent rule' for the deductibility of superannuation contributions to provide greater incentive and flexibility to people who have to make their own superannuation provisions.

4.5.7 Taxation of superannuation death benefits

CPA Australia believes the tax treatment of all superannuation death benefits should be consistent for dependants and non-dependants.

The payment of death benefits to dependants after 30 June 2007 are tax free (with the exception of income streams to dependants under age 60), while the taxable component of death benefits paid to non-dependants is taxed at 15 per cent.

This provides arbitrage opportunities. For example, an individual knowing they are going to die will be able to take their superannuation benefit as a lump sum and pass it on to their adult children tax-free. On the other hand, where death is sudden and unforeseen, the benefit may still be paid to the adult children but it would be taxed at 15 per cent.

Strategies are also being promoted in the market to minimise this tax treatment. For example:

- re-contribution strategies where the taxable component is withdrawn over time and re-contributed as an undeducted contribution, effectively reducing the taxable component to nil, or

- separating the taxable and tax-free components into separate superannuation funds with the tax-free component payable to the non-dependant/s on death and the taxable component to the dependants.

These strategies create inequities within the system as the people with the knowledge and ability to seek out advice will benefit, while those who need it the most may miss out.

At present, in pension phase the current interpretation of the law by the ATO is that the final payment after the death of a pensioner is being treated as a lump sum. Consequently the interest is in accumulation phase at the time of payment and CGT becomes payable. CPA Australia believes that as the interest was in pension phase, the final payment should be the finalisation of the fund's pension obligations and treated as such.

CPA Australia believes the tax treatment of superannuation death benefits needs to be reviewed in a holistic manner to ensure consistent and equitable treatment of payments to dependants and non-dependants alike. In particular:

- The taxation of all superannuation death benefits should be consistent, i.e. tax free.
- The current inconsistencies between the definitions of 'dependant' in the SIS Act and the Income Tax Assessment Act 1936 be removed by aligning the definition of 'child' in the ITAA 1936 with that in the SIS Act.
- The appropriateness and utilisation of 'anti-detriment' payments be reconsidered
- The final payment of an income stream upon death to be treated as an income stream payment not a lump sum.

Recommendation: 4.5.7

The tax treatment of superannuation death benefits to be reviewed to ensure consistent and equitable treatment of payments to dependants and non-dependants alike.

4.5.8 Exclude overseas benefits from contribution limits

CPA Australia believes benefits transferred from overseas superannuation funds should be exempt from the contribution limits. Given these benefits are treated as if they have been accumulated in the Australian superannuation system, i.e. they are taxed accordingly, the individual should have the opportunity to add them to their Australian superannuation benefits. Applying the limits may actually make it difficult, if not impossible, for individuals to transfer their retirement savings into Australia as there will be situations where overseas funds will not permit partial transfers of benefits. As such, the transfer amount should be exempted from the limit on non-concessional contributions and the amount elected to be treated as taxable contributions, i.e. the earnings, should be exempted from the concessional contribution limit.

We understand there may be concerns that such an exemption may provide the opportunity for individuals to funnel contributions through overseas superannuation funds and hence bypass the contribution limits. However, we believe the risk of this is low, due to the difficulties involved with residency, termination of employment, taxation and payment rules, compared to the importance of allowing, and encouraging, expatriates to consolidate their retirement savings in Australia.

This issue was recognised by The Senate Standing Committee on Economics in its inquiry into the simplified superannuation legislation, where it recommended that the government consult with the superannuation industry to develop anti-avoidance measures to allow bona fide overseas transfers in excess of the non-concessional contribution cap.

Recommendation: 4.5.8

Introduce measures to enable transfers from overseas superannuation funds to be excluded from the contribution cap limits.

4.6 State taxes

As mentioned in many earlier CPA Australia submissions over the last four or five years, CPA Australia believes that the Commonwealth should work co-operatively with the States to increase the efficiency of state tax structures to benefit Australian business and the economy, such as via a new Intergovernmental Agreement to supplement the earlier 2000 GST Agreement.

Proposed reform of state/territory taxes under a new Intergovernmental Agreement (IGA) should include the following:

- removal of duties on business real property and insurance premiums
- appropriate harmonisation of existing state/territory land taxes at a relatively low single rate in lieu of the current complex multi-rate structures in most jurisdictions
- replacement of existing motor vehicle duties with taxes which are more closely linked to motor vehicle usage such as congestion/road user charges
- extension of a modernised land tax to residential property in lieu of existing duties on property transfers
- removal of existing state environmental taxes in conjunction with the introduction by the Commonwealth of its proposed carbon pollution reduction scheme (CPRS) in 2010.

The cost of the abovementioned reforms should be partially met from the increased revenues generated by a more efficient economy, while the remaining cost could be funded from increased GST revenues via the current IGA.

Any funding shortfall could be addressed via one or more of the following:

- increased financial restraint by the various states/territories
- removal of unnecessary state tax expenditures
- appropriate federal assistance to the states
- re-introduction of a modified form of the pre-2000 Commonwealth income tax sharing arrangements with the states, and
- if appropriate/necessary, a review of the existing distribution of functions between the Commonwealth and the states.

Business compliance costs could also be reduced via:

- ongoing harmonisation of state/territory pay-roll taxes and other remaining state taxes, and
- transferring responsibility for the administration/collection of state/territory taxes to a single agency (such as the ATO) while the various jurisdictions still retain responsibility for tax rates, thresholds and administration policy.

Among other things, the above changes would clearly simplify the tax system interactions between federal, state and local governments.

While the above changes could exacerbate the existing vertical fiscal imbalance problem (VFI) problem, we believe that this issue could be addressed by greater transparency in Federal/State financial arrangements to ensure that the electorate is more aware of where revenue raising and spending responsibilities rest. We do not favour the recent proposal by the Senate Committee on 'State Financial Management' to give income taxing powers to the states since we believe that would result in increased complexity and is, in any event, effectively the same as the revenue sharing arrangements which we have proposed above.

Recommendation 4.6

CPA Australia recommends that further reform of the remaining inefficient state/territory taxes be addressed by the Commonwealth and the states in the context of the current review and the COAG process as appropriate.

4.7 Tax Mix/ Funding issues

The reforms proposed above are unlikely to be entirely revenue neutral and do not, of course, fully address the tax mix issues raised in the Treasury paper. The main reasons for this are as follows:

- the fact that the Government has ruled out any consideration of changes to the GST tax base and rate,
- the difficulties involved in reforms to existing state payroll taxes (such as broadening the tax base and/or increasing the tax rate) due to concerns regarding the impact of such changes on business, and particularly small businesses which are currently below the various zero rate thresholds and effectively exempt from the tax, and
- the Government's indication that all of the expected CPRS revenues will be used to ameliorate the impact of the scheme on the groups identified in the recent Green Paper.

Similar considerations also apply to potential land tax reforms although moving to a single rate model on a broadly revenue neutral basis as proposed above on efficiency grounds may be feasible.

We note also that, notwithstanding that Australia's existing taxes on fuel are less than those imposed in most other OECD countries, there may be difficulties in increasing existing fuel taxes given community sensitivities associated with this issue and the fact that the cost of fuel is expected to increase as a result of the introduction of the proposed CPSR. While such increases are expected to be moderated in the short-term for households and certain other users, other specific increases in fuel taxes could be seen as inconsistent with the Government's CPSR commitments in this area.

Recommendation 4.7

CPA Australia recommends that further consideration be given to the role of broad-based indirect taxes in Australia's overall tax mix in the light of our proposed reforms.
Recommendation 4.8

4.8 Taxation of cross-border investments

CPA Australia believes that the company tax reforms (such as the proposed tax rate reduction and removal of the existing anomalies in the tax base) canvassed above will enhance Australia's international competitiveness.

We note that the Board of Taxation (BoT) is currently reviewing the existing anti-tax deferral rules with the aim of reducing the associated complexity and compliance costs and ensuring an appropriate balance between countering tax deferral while not unnecessarily inhibiting Australians from competing in the global economy. CPA Australia supports this review and its early completion by the Board.

In this context, we also welcome the Government's initiatives aimed enhancing Australia's position as a regional services hub including:

- current review of managed investment trust arrangements by the BoT
- recent changes to the trading trust rules in Division 6 (ITAA 1936) to reduce compliance costs for Australian funds
- recent withholding tax rate cuts (from 30% to 7.5% over three years) for fund payments to residents of relevant jurisdictions, and
- the current review of Australia' double tax treaty (DTA) negotiation program.

Recommendation 4.8

CPA Australia strongly supports the current and proposed measures being pursued by the government in the area of cross border transactions and looks forward to their early completion.

4.9 Tax complexity

Consistent with the tax system design principles outlined in section 2 above, CPA Australia strongly supports measures to minimise tax complexity. We note that the following measures proposed above should reduce the complexity of the Australian tax system:

- proposed flat rate of tax on capital income
- proposed rationalisation of state taxes and their administration by a single agency going forward
- proposed rewrite of the FBT Act
- removal of the Medicare Levy (and related surcharge arrangements), and
- the removal of welfare benefits from the tax system and rationalisation of existing benefits.

Complexity also arises from the use of various different structures (such as partnerships, companies and trusts) for business and investment purposes. While the proposed change to the taxation of capital income may ameliorate this problem, we also note that the Government proposes to consider the suitability of applying the proposed legislative regime for managed investment trusts to other trusts (such as family trusts) following the completion of the BoT's current review of MITs.

Other measures to reduce tax complexity and associated compliance costs could include removal of the following:

- those taxes which collectively raise little revenue such as the existing 67 agricultural levies, and
- minor state and local government taxes such as those in the environmental area and customs tariffs which have primarily a minor revenue raising function.

On the basis of the figures contained in the Treasury 'Architecture' paper, such action could eliminate more than 100 existing taxes. For those businesses operating in more than one jurisdiction, this change together with having a single agency to administer all state taxes would further reduce complexity and compliance costs.

Recommendation 4.9

CPA Australia recommends that appropriate measures be implemented to minimise the complexity of the Australian tax system including the measures flagged above.