

## Inequity in the tax treatment of Australia's citizens and residents.

### Submission to Australia's Future Tax System

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#### What are the problems with the current system?

*"Equity is an important objective of the tax-transfer system. There is no unanimity about how best to assess equity but [one of the] two fundamental principles [is]: horizontal equity, which requires that individuals in the same economic circumstances pay the same tax."*

(Section 3, Key points - Architecture of Australia's Tax and Transfer System).

The Australian tax system has attempted to respond to the need for skills and the global movement of skilled workers and capital in a way that benefits the Australian economy through the legislation of tax exemption for 'temporary residents'. However, the perhaps unintended or unthought-out consequence of this has been gross horizontal inequity.

The current system of double taxing Australian citizens and residents on New Zealand sourced dividend income while New Zealand 'temporary residents' can live for all intents and purposes as Australians, yet remain indefinitely tax free, is amoral.

An Australian citizen and/or resident with New Zealand source dividend income is double taxed to the tune of 58%. If shares are held in trust then the tax burden is even more punitive as the final distribution bears an effective tax rate of 64%. The insult to injury brought about by the legislation is that, a New Zealand 'temporary resident' with the same NZ shares living in Australia enjoys a 33% effective tax rate on dividend income not mention tax free status on all other income.

	Australian citizen/resident shareholder receives NZ dividend direct.	Shares held in NZ trust and distributed to Australian citizen/resident.	NZ 'temporary resident' living in Australia (receiving direct or through trust).
Total NZ Cash Dividend.	1492	1492	1492
Residual Cash (minus Imputation Credit + FTIC – OZ tax)	630	535	1000
Total Tax	862	957	492
Effective Tax Rate	58%	64%	33%

No recognition for triangulation to illustrate general shareholding in NZ businesses with no Australian operations rather than portfolio shares.

NZ corporate tax/Imputation Credit @ 33%.

OZ Tax @ 46.5%

## What reforms do we need to address these problems?

Under the auspices of the CER (Closer Economic Relations) between New Zealand and Australia, Trans-Tasman mutual recognition of imputation credits is long overdue and in light of the gross inequities now thrown up by the 'Temporary Resident' legislation, must be implemented.

While foreigners enjoy tax free status for four years, New Zealanders enjoy it indefinitely yet also enjoy home ownership and other privileges of residence with the only provisos being that they pay for medical expenses and schooling. However, with 'temporary residents' taking advantage of private medical insurance and the very reasonable fees demanded for public schooling (or indeed taking up private schooling), it is now incontrovertible that, where a New Zealand family and an Australian family benefit from the same New Zealand shares, there is greater advantage in being a New Zealander living in Australia and great disadvantage in being an Australian living in Australia.

This issue must be redressed but in broad based and beneficial terms to both sides. Australia must ensure that Australian citizen and resident families do not continue to be second-class financial citizens in their own country yet without taking a step backwards into bygone tax policy.

While the wider objective of the legislation exempting tax on foreign source income for foreign 'temporary residents' is understood and the concession serves the intent of attracting skilled workers to Australia initially, it is a myopic solution as the concession evaporates if those skilled workers were to marry Australians or settle permanently and thus it ultimately discourages retention of the skill base in Australia.

The more laudable way forward, rather than tax free concessions for some and double tax for others, is surely an across the board, full annulment of double taxation coupled with a competitive tax rate. This would serve to maintain Australia's attractiveness and competitiveness in the world labour and capital markets whilst also fostering faith in those becoming full residents and citizens; or otherwise leaving.

An interesting note is that Britain has begun to close down the inequities wrought by the anachronism of its "Non-Domicile" tax laws. Yet, Australia is opening a new chapter in tax inequity in the form the tax concession for 'temporary residents'. If there is such sound benefit for the economy of this kind of tax strategy then the least Australia must do is to ensure that its own citizens and residents are not at the same time unduly punished for living in their own country.

It is also interesting to note that the tax concession for 'temporary residents' rather than a fair-to-all imputation agreement or other solution(s), now cements the awful notion that marrying an Australian is a peril to be avoided(\*).

Furthermore and absurdly so, Australia grants tax free status indefinitely to New Zealanders living in Australia and New Zealand grants tax free status to Australians migrating to New Zealand for four years (hardly reciprocal) yet neither country is being reasonable to its own citizens and residents with regard to trans-tasman dividend flow and taxation.

(\*) 'Temporary residents' lose their status and become full residents for tax purposes if they marry (or enter into a de facto relationship?) with an Australian.

**What features should the system have in order to respond to these challenges?**

*“Australia is one of only a few countries that still has a dividend imputation system but many other countries provide some form of relief to resident shareholders (for example, by exempting all or part of the dividend, or taxing dividends at reduced rates)”*

(Section 8 of the Architecture of Australia’s Tax and Transfer System)

If Australia is to maintain its dividend/franking imputation system (along with New Zealand) then the only avenue it has to achieve fair and proper horizontal equity with regard to Australians and New Zealanders is to repeal arbitrary tax concessions in favour of Trans-Tasman mutual recognition of dividend imputation.

Clearly, for good reasons, many other OECD countries have abandoned imputation/franking adopting instead policies that achieve a greater horizontal equity for individuals and at the same time reducing the bias against international investment and against their multinational companies with international operations.

The relative merits of those policies (• Exempting all or part of the dividend or • Taxing dividends at reduced rates), will no doubt be argued in academic submissions, but certainly, these alternative solutions to dividend imputation would circumvent the so called “first and favoured” terms in Australia’s double tax treaties currently stymieing full annulment of double taxation between New Zealand and Australia.

## **Summary**

This author’s Australian family, due to all prudence, fiduciary duty and the compounding cost of a 64% effective tax rate, have had to relocate to New Zealand. Meanwhile, our New Zealand counterpart shareholders toast their tax-free lives in Australia.

We have taken with us not only all tax revenue Australia could otherwise receive, but also the potential of local business building investment and its economic benefit.

Without reform, our Australian family– and other families like ours - will no doubt remain abroad and employ their skills and capital in another country that bears its residents greater respect in the form of fair and equitable tax treatment.

The bias in the dividend imputation system against Australian multinational firms, foreign investment and the effect on cost of capital is already well discussed and documented; as is the benefit of Trans-Tasman mutual recognition of imputation to Trans-Tasman business and investment.

Australia must now, especially in light of the gross inequity with regard to the ‘temporary resident’ legislation, consider the fair play with regard to Australian citizens and residents and do more than past governments have done to fully address the issue of Trans-Tasman double taxation.

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