Submission

Australia's Future Tax System Review

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Our client base has historically been privately owned businesses, and their owners, although we now have a substantial share of large corporations. Many of the views we express are on behalf of privately held businesses, being a very significant part of the Australian taxpayer base.

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Introduction

The Federal Government announced Australia's Future Tax System Review (Review) in May 2008.

As noted in the terms of reference for the Review, it will consider a range of broad and fundamental issues concerning the balance of taxation and costs, interaction with the tax transfer system, simplification and the interaction between various levels of Government taxation.

We note that the review will not make recommendations contrary to the Government's policy to:

- not increase the rate or broaden the base of the Goods and Services Tax (GST)
- preserve tax-free superannuation payments for the over 60s
- not amend proposed changes to personal income tax rates

We understand that the review panel is looking for public responses to focus on four questions, being:

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

Accordingly, the following chapters will address these questions.

This initial submission is general in content. We look forward to making more detailed and specific submissions during the course of the Review. We would appreciate an audience with you to discuss our views.

What major challenges need to be addressed through the tax – transfer system, and what features should the tax system have in order to respond to these challenges?

The taxation system is integral to the growth of our economy. It is integral to enhancing productivity in Australia and ensuring that we have an internationally competitive business environment.

A large number of Federal taxes are imposed on taxpayers of all types. The system must be revamped to remove complexities and reduce the number of taxes, so that the system is more easily understood by all stakeholders. Stakeholders include taxpayers and the officers of the Australian Taxation Office and other Government officers who administer the system. **The review must start by revisiting the overall purpose of taxation policies.**

The time spent by Australian taxpayers in administering and managing their tax liabilities is detrimental to business performance, productivity and profitability. The revenue base is undermined by our system giving rise to high compliance costs. This must be addressed.

The tax system is integral to ensuring that there is equity in the Government's welfare programs.

We do not intend to elaborate in any great detail in this submission on details of how the tax transfer system can be improved. However, we note that:

- in number, **there are too many taxation or quasi taxation imposts imposed on business and individuals**
- the number of duties or levies on taxpayers, where the tax base is other than income they derive, must be reduced
- qualification for welfare-based tax offsets needs to be simplified – at the moment it is far too complicated to determine which individuals or families qualify for various forms of offset
- **rules relating to offset eligibility are too complicated** – they need to be better understood by the taxpayer population
- the use of tax offsets to incentivise various parts of the economy will continue to be a feature of the system, and no doubt the use of offsets (and refundable offsets), such as in relation to areas such as research and development, will be the subject of further individual reviews depending on

what particular initiative is being incentivised; again, the message that we hear from clients is clearly that these measures need to be capable of being better understood by taxpayers

- there should be a review of the taxation of returns on simple savings to reduce taxation on interest earned by individuals; **there is a disparity in the taxation of interest, when compared to other returns such as capital gains or franked dividend income**
- encouragement should be given to measures that support investment in order to stimulate the economy, such as debt deductions for investors (even where negative gearing exists)
- **taxation of the family unit**, as opposed to taxation of each family member, might be a basis for more equity in the individual tax base, and reduce the reliance on wide ranging tax transfer payments

What are the problems with the current tax system and what reforms do we need to address these problems?

The current taxation system in Australia is far too complicated, and there is a drastic need to simplify it so all taxpayers have clarity as to their liabilities and obligations. Officers of the revenue authorities would also benefit from greater clarity of the law, its interpretation and administration, and this would breed a culture of better understanding and co-operation between taxpayers and revenue authorities.

However, before issues to do with the administration of the system are dealt with, the structure of the taxation system needs to be fundamentally revised.

For instance, **the Federal income tax system has become lost in a maze of design complexities.** In the eyes of many, it no longer is seen to be fair or reasonable.

In our view, the system needs to be reviewed by seeking direction from answers to the following questions:

- **What is the tax base?**
- **Who should pay the relevant taxes?**
- **How should the taxes be collected?**

The current income tax system is fundamentally skewed by the **divergent treatment of income and capital gains**. While this is not so in respect of the taxation of companies, for individuals (being the investor base) there is great disparity in the taxation imposed on returns from various forms of wealth accumulation such as, gains on the sale of investments, gains on the sale of a principle place of residence and gains made on the sale of business assets (in particular depending on whether small business tax concessions are available). The high rate of individual taxation means that there is a drive to earn tax free or concessionally taxed capital gains in lieu of ordinary income. Individual tax rates are too high. However, if the policy is to support long-term investment and saving, then concessional tax treatment of gains on realisation should be supported. Maybe a solution is for sensible tapered relief, as opposed to the "guillotine" application of our CGT reliefs (eg on holding assets for at least 12 months). The application of small business concessions based on whether a taxpayer falls either side of a $6m value test is also inequitable.

The law is often drafted in a piecemeal way in order to catch perceived losses to the revenue from identified mischiefs. This can give rise to unintended consequences and unforeseen liabilities. We believe that taxpayers are tired of being "unintended" subjects of tax liabilities that arise from unfortunate drafting of the law. This is inequitable. But it can be rectified by a conscious effort to simplify the law along the lines of better defined policy.

The system is made unnecessarily difficult by the different regimes that apply to different entities, be they individuals, partnerships, trusts or companies. For example, taxpayers, administrators and the courts repeatedly have to deal with peculiarities arising from the taxation of trusts, and, in particular, issues arising from having to determine who is "presently entitled" to income of the trust in a year of income (so that they are subject to taxation on the trust's net income).

Tax planning arises around the disparity of income tax rates between companies and individuals. This is accentuated where, for example, companies receive tax benefits or concessions (eg access to small business capital gains tax concessions). Upon the distribution of that untaxed income to shareholders in the form of unfranked dividend income, there is another level of taxation that effectively denies the benefit of the concession.

Thought should be given to applying a rate (or a simplified band of rates) to all entities, including individuals, based on taxable income or gains that they derive. This would mean that the distributions from entities could be largely untaxed, or exempt.

Application of more aligned rates of tax between entities and individuals would mean less reliance on legislation such as the PSI rules, dividend imputation, and many anti-avoidance rules.

Tax collection points need to be more effective to streamline the administration of the system.

In relation to the Federal/State taxation divide, our key advice would be to:

- **remove nuisance taxes** or taxes lacking good policy support (such as pay-roll tax)
- **harmonise remaining state taxes** so that there is no impediment to doing business across states by having to resolve varying and ambiguous state tax laws (as has traditionally applied to stamp duty)
- **avoid having multiple taxes apply to the one transaction or event**

According to the Grant Thornton International Business report of 2008, **privately held businesses in Australia are straining against multiple employment taxes**.

Almost a third (29%) of business owners rank employment-related taxes as the greatest burden on their business, followed by taxes on business profits (18%) and personal income tax (17%).

Companies in many states – including South Australia, Western Australia and New South Wales – believe that staff-related taxes are far more excessive then corporate taxes, illustrating the strength of feeling around the volume and complexity of employment taxation in Australia.

You would expect that business owners would be most concerned about taxes directly imposed on them: paying once on their company profits and again on the dividends they receive as an individual.

However, **this research shows that they're more concerned by their multiple exposure to employment taxes**, from paying the States for employing someone, to dealing with ambiguous areas like fringe benefits.

[Australian respondents put a higher emphasis on employment-related taxes than many of their international counterparts.

Whilst global respondents were equally downbeat about employment taxes and business profits (each taxation area receiving 24% of votes), Australian companies reserved their firepower for payments like payroll tax, workers' comp and employment on-costs. The focus rose from a national average of 29% to as much as 42% in Western Australia and 38% in South Australia. Victoria was the only state to place equal emphasis on staff-related taxes, and personal income tax.]

In summary, we look forward to contributing in more detail to the Review as it proceeds by making further submissions. We hope for a fresh approach to the policy that drives what is our taxation base, who pays tax, and how our taxes are imposed.

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