The National Institute of Accountants

Submission to the Review of Australia's Future Tax System

October 2008

NATIONAL INSTITUTE OF ACCOUNTANTS

Every member counts

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The National Institute of Accountants (NIA) welcomes the opportunity to make this submission to the Review Panel on Australia's Future Tax System, which is widely considered to be one of the most significant reviews into Australia's taxation system.

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

Accordingly, our submission is made from both the perspective of our members, two-thirds of who work in and around small business; with regard to matters, which affect the public interest.

In preparing our submission the NIA has consulted extensively with our members, holding consultation sessions in eight different cities around Australia (Sydney/Parramatta, Melbourne, Brisbane, Canberra, Adelaide, Perth, Hobart and Launceston). We have also encouraged input from our members and received a large number of electronic input directly from members. In addition, we have received input and comments from the members of the NIA Faculty of Taxation and also consulted widely with other stakeholders.

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

Roger Cotton
Chief Executive Officer

Introduction

The NIA appreciates that the Review into Australia's Future Tax System is far-reaching and is expected to consider a large number of matters and issues affecting the tax transfer system and all taxpayers.

The NIA trusts that the comments and recommendations will be useful not only to the Review Panel but also to the Government, the Treasury and the Australian Taxation Office (ATO) in terms of informing them of the issues and concerns of our members, their employers and clients.

List of recommendations

The Government should consider the following:

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

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

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

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

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

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

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

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

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

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

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

Recommendation 12: Reforming Capital Gains Tax (CGT) to include consideration of a scaled rate of CGT; and improving the operation of the CGT rules.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Workforce participation

As documented by the Organisation for Economic Co-operation and Development (OECD), Australia's labour market participation rate is below the OECD average. In the NIA's consultation with members, the issue of encouraging workforce participation was one of the major topics of concern.

Given the changing demographics documented in Treasury's *Intergenerational Report 2* it appears imperative that people be encouraged to enter or re-enter the workforce. One option to achieve this is to reduce effective marginal tax rates, especially at the bottom of the income scales. We appreciate this has been an area of ongoing focus by Government and by Treasury.

One suggestion is to increase the tax-free income threshold, over a period of time. Welfare payments, which are indexed, have progressively over the last couple of decades become higher than the tax-free income threshold, which is lower than the unemployment benefit. The low income tax rebate does not go far enough in addressing this imbalance.

Even though the cost to revenue of this measure, to increase the tax-free income threshold above the unemployment benefit, would be considerable, the benefits of encouraging increased workforce participation given an ageing population, encouraging a shift from part-time and casual employment to full-time employment, reductions in welfare payments, increased productivity and the reductions in complexity and compliance costs, could be reasonably expected to outweigh the cost, especially if introduced over a period of time. In addition, a measure of this type would obviate the need for constant 'tinkering' with rates, thresholds and other parts of the personal income tax system. Even though this reform would reduce effective marginal tax rates for all taxpayers, the most benefit would be concentrated at the lower end of the spectrum.

There is a large amount of literature and commentary on the benefits of cutting taxes and the positive impact this has on increasing revenue. One survey by Sinclair Davidson concludes that Australia is on the wrong side of the Laffer curve, that is, tax cuts would result in increased revenues (one example is the increase in revenue after the Government of the day reduced the corporate tax rate from 36 per cent to 30 per cent between 2000 and 2002).

Another major benefit with increasing the tax-free income threshold is that a range of deductions and rebates could be repealed and removed from the system, thereby reducing complexity and the compliance burden.

Against a background of an ageing population these direct and indirect benefits are important for building and sustaining Australia's future economic growth.

Another option is a system of earned income tax credits or negative income taxes as they are also known which has proved successful in countries such as the USA, UK and other European countries which have all considered a range of measures to tackle the same problem. Again, the expected flow-on effect would be an increase in workforce participation.

Other suggestions for increasing workforce participation include:

- Pensioners should be incentivised into the workforce, for example, by considering investment income as the major source of income and not including work/labour income (or not including work income above a certain amount) for tax purposes. In this way pensioners would be allowed to earn a reasonable level of income before their pensions are affected. In addition, by allowing a reasonable amount of income before pensions are affected will act as a stimulus to the overall economy.

- Providing more incentives through the tax system to encourage employers to hire more apprentices as the current level of government support is considered inadequate.

- Encouraging apprenticeships by having accounting and business students spend at least, one day per week working in a firm. This will prepare them more usefully for full-time employment after graduation.

Recommendation: In order to encourage workforce participation the Government should consider increasing the level of the tax-free income threshold relative to unemployment and welfare benefits.

Retirement incomes policy

The NIA believes that one of the main goals of the Government should be to develop and implement policies which will ensure a secure and sustainable retirement income for all Australians. This includes supporting and encouraging individual contributions to retirement savings throughout a person's working life.

There can be little doubt that despite numerous public pensions, concessions and allowances, it is unlikely these will be adequate for future retirees, given the ageing of the population and changing expectations of retirement. However, current evidence indicates that Australians have inadequate retirement savings in superannuation funds and that more needs to be done to increase the level of retirement savings. The OECD states that evidence from most countries shows that workers almost consistently underestimate their financial needs in retirement and many underestimate their life expectancy.

In addition to the outcomes from the Pension Review, the Government should also consider the following policy options (which are discussed further below).

- Rationalising and streamlining the numerous pensions, concessions, allowances and other payments which are made to older Australians with the aim of achieving efficiency gains in order to lower costs for older Australians.

- Developing further measures to remove incentives for early retirement and to provide positive incentives for delayed retirement, such as reduced rates of income tax, without penalising those who choose to retire early or completely from the workforce.

- In partnership with industry, business and the community, the Government should strengthen and support efforts to educate people throughout their lives on the importance of retirement planning and financial education generally.

In the *Intergenerational Report 2*, Treasury estimates that people relying on the age pension will drop from two-thirds to one-third of all age pensioners by 2050. Australia's proportion of pension outlays to GDP is one of the lowest in the OECD at a projected 4.6 per cent by 2050 against an average of 10.8 per cent of GDP average for OECD members.

Public pension spending varies across the OECD from less than 1 per cent to 10 per cent of GDP. The target pension varies between 30 per cent and 100 per cent of individual earnings. Trends seem to be toward tightening pension eligibility; indexation of pensions has become less generous; some pension schemes link benefit levels to changes in life expectancy; and the introduction of defined contribution pensions where the private pension benefit depends on contributions and investment returns.

Against this background, the Government should target its policy responses to those who need it the most and to build a sustainable retirement income system which requires increases in private contributions. Part of this is recognising the interaction between the various drivers including economic growth, the taxation and transfer systems, superannuation and the financial and labour markets more generally. Another part is to remove policy induced distortions.

Other suggestions relating to boosting retirement income include:

- Conducting a 'boomer' lottery where tickets would be sold in the same way as a normal lottery; however, the monies would be kept in a Pension Fund with some funds being paid out as prizes. The concept is the same as that applied to repaying the cost of building the Sydney Opera House.

- Providing an exemption from capital gains on the disposal of either real estate or share investments if they have been held for a specific period of time, say 15 years and the proceeds have been rolled over into a superannuation fund. This would be consistent with the small business concessions where businesses have the opportunity to roll over the proceeds on sale to a superannuation fund tax-free.

- Another suggestion is to consider aligning the pension more closely with the cost of living in each region, to take into consideration the fact that some areas, such as Sydney are more expensive to live in than say a small town in

Tasmania. Qualifying conditions would be included to protect the integrity of the provisions.

Recommendation: The Government should consider innovative ways to address the issues of inadequate retirement incomes; including extending the small business CGT concessions to other categories of taxpayers.

Rationalise and streamline pensions and concessions

One simple example which demonstrates the 'over-engineering' of some of the concessions is the pensioner tax offset; which must be calculated depending on numerous variables including whether you are single, widowed, separated, if a couple, whether one is in a nursing home, whether you are a veteran, war widow or war widower, whether you've lived apart due to illness, whether your taxable income is more or less than a certain amount, whether you receive all or some or none of the offset, there are lower and upper taxable income thresholds and unused tax offset can be transferred to your spouse.

The process of simplification and streamlining could also incorporate delivery which is undertaken by various government departments, at the federal, state and local levels and by not-for-profit organisations. It is not unreasonable to assume that at least some of the delivery of these services is occurring on an ad hoc basis with the implication that any efficiency gains would translate into lower costs for the delivery of these services or pensions.

During member consultations we received numerous complaints about the 'hassling' of those receiving a pension and what was considered an enormous amount of 'red tape' and constant requests for information from government agencies.

Recommendation: Rationalise and streamline pensions, concessions and allowances with an emphasis on reducing complexity, duplication and inefficient programs.

Early retirement

An integral part of achieving higher retirement incomes, which is reliant on continued economic growth, is ensuring in turn that the taxation, superannuation and social security systems do not interact to discourage labour force participation or provide other incentives for early retirement. In fact, the importance of labour force participation cannot be overestimated. As the *Intergenerational Report 2* states, encouraging greater labour force participation continues to be important for improving economic growth and living standards.

The focus may even shift from removing incentives to early retirement to a more positive system of incentives to delay retirement and stay in the workforce. One possible means for achieving this is to introduce lower income tax rates for people aged over 60 (given that taxed superannuation will be tax-free for those aged 60 and over) on the basis that they continue to work at least part-time. However, it would be essential that integrity measures are in place to prevent abuse (eg older Australians being employed by their children's business performing light duties with the objective of qualifying for the reduced tax rate). This would also increase complexity (unless Part IVA can be relied upon at least in part).

At the same time, it would be important to ensure that those who choose to retire will not be penalised.

The revenue impact from this measure is likely to be neutral or positive taking into consideration the saving in pensions and the increased taxation revenue from workers who might otherwise be completely retired and paying less tax. There is also the increased productivity to be derived from shifting this segment of people from the pension system or retirement into the workforce.

The OECD recognizes that increasing the effective age of retirement, which has fallen despite increases in life expectancy, would be a great help in dealing with the demographic burden of an ageing population. This would have a double positive effect – reducing benefit expenditure and increasing tax and contribution revenues. The OECD's approach in promoting the removal of early retirement incentives, is to stop subsidies for early retirement such as having little or no reduction in benefits on earlier retirement; resource tests encouraging low earners to retire earlier; little or no extra benefit for longer contributions; not being able to combine work and retirement.

Australia has gone some way to addressing these obstacles, especially making it easier to phase into retirement by drawing on superannuation whilst working. Allowing people to earn a reasonable amount of money by working without affecting their pension entitlement would also be welcome by most retirees. The OECD points to widespread evidence to show that pension incentives affect retirement decisions (as well as many other factors like health and the state of the economy) with employment rates of older workers increasing with retirement incentives.

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

Utilising mature age workers

Further policy responses are required to make it easier for older workers to re-enter the workforce, especially for some who may be experiencing barriers to re-entering and may need retraining and encouragement. It is essential to ensure that labour and capital markets respond to the ageing population and to the effects on productivity. Sustained economic growth in the longer term, which will rely on a higher employment participation, will have to address this major demographic change and utilising mature age workers will have to become a necessity rather than an option.

This will also require mature age and older workers to take responsibility by ensuring that their skills are up to date, especially technology related skills, and that they embrace opportunities to participate. Government support through the tax transfer system in this area will be crucial.

Research by the OECD indicates that mature age workers are highly productive; they can mentor junior staff and are more loyal with a lower churn rate than younger workers. In addition, for business, reflecting the customer base as the population ages will have practical commercial benefits.

In some industries it is a question of sheer necessity. For example, there is concern in the tax agents industry that the age profile of tax agents is increasing with not enough people entering the industry. It is projected by the ATO that 24 per cent of tax agents will leave the industry over the next two to three years.

Obviously there will be tension between expecting to retire by a certain age and continuing to work (or feeling coerced to work) until a comfortable retirement can be secured. This may require a change in societal attitudes. However, the point here is that if older workers want to remain or re-enter the workforce to ensure a (more) financially secure and comfortable retirement then they should have the opportunity to do so. In order to provide this opportunity, government, business and industry may need to constantly reinforce the message of active and continued participation in the workforce in order to enjoy a more comfortable retirement. Another part of the message is that the age pension should be regarded as a last resort safety net, simply because future governments will have less capacity to pay it due to decreased tax revenues.

Recommendation: The Government should consider measures to encourage and support the retention and re-entry of mature age workers into the workforce, including adequate skilling.

Superannuation

The previous Government introduced significant changes to the retirement savings system through its simplified superannuation measures. While these improved many of the long-standing problems with the superannuation system, it did not deal with one of the major problems with the Australian system, that is, upfront taxation of contributions.

Contributions Tax

Taxing contributions discourages personal contributions and reduces the amount of investment returns that those additional funds would bring on retirement. The contributions tax was introduced in part as an 'equity measure' but also largely as a revenue raising exercise at a time when the Government was in need of additional revenue.

These rationales can no longer be maintained. Furthermore, when seeking non-inflationary tax changes, reducing or eliminating the contribution tax, could be beneficial. These contributions will remain non-inflationary because they will remain in the funds for years to come in most circumstances and not be fed into the current economy. Therefore, it is possible to achieve tax reform, more money on retirement for taxpayers with little to no inflationary pressure.

With respect to personal contributions by non-employees we suggest that even if the Government was not prepared to reduce or eliminate the contribution tax for all contributions, they could be removed in specific circumstances such as:

- Personal contributions up to a capped amount of $5,000 for those earning under $100,000; and

- Personal contributions for those between the age of 50 and 65 and who have less than $250,000 in superannuation savings (this is to help older Australians who may not have had superannuation contributions for their entire working life and particularly women who have left the workplace to raise children for a period of time).

One study by IFSA showed that over the life of savings that up to an additional $2.51 in superannuation savings would exist for every $1 of contributions tax forgone. One suggestion is that all superannuation contributions to complying funds should be tax deductible with the removal of contributions tax. A limit on the amount of contributions can be maintained, however, it should be increased, especially to cater for taxpayers who have not had the opportunity to make a reasonable level of contributions over their working life.

Other suggested changes to the superannuation system include being able to pay into superannuation past the age of 70 years.

There was widespread support from members for increasing the superannuation guarantee to perhaps 12 per cent and introducing the increases gradually. However, there was also widespread concern that small business would not be able to afford the increase and it would act as a disincentive to further employment. In addition, the increase should be paid either by the government, unions, the employee (using salary sacrifice); the employer, or a combination of these. There was also concern that in any event not all employers were paying the superannuation guarantee and that the ATO should focus on enforcing compliance more rigorously.

Recommendation: That the Government remove the 15 per cent contribution tax on superannuation contributions to encourage more contributions and provide a non-stimulatory form of tax reform. Superannuation funds should be exempt from tax on all income and gains with payment of benefits to members being taxed at their marginal rate. If the Government is not so minded then contributions tax should be removed to help promote additional superannuation contributions for those who are not eligible for co-contributions but not on high incomes and those who are nearing retirement but have inadequate superannuation savings.

Deductibility of superannuation contributions

The employment circumstances that exist in the current economy are different from those when the superannuation system was first introduced. There are many more people who are ‘contractors’ or self-employed and many who undertake additional outside contracting work in addition to their normal jobs. While the simplification measures addressed in part some of the disparities that self-employed people face, there are still impediments that need to be removed.

The NIA recommends that the ‘10 per cent rule’ be abolished as this would allow employees who have an additional side business to claim deductions for their personal superannuation contributions. The contribution limits would prevent abuse of the system.

Recommendation: The Government should abolish the ‘10 per cent rule’ on the deductibility of superannuation contributions to give greater flexibility for those people who have to make their own superannuation provisions.

Death Benefits

While the NIA was supportive of the superannuation simplification reforms, the NIA raised the incongruity that was installed in relation to death benefits. Australia does not have an inheritance tax and distributions on death are usually tax-free. However, under the current arrangements where a person dies their superannuation savings are treated differently in different hands. While they are tax-free to dependents (except for income streams to those dependents under 60) they are taxed in the hands of non-dependents.

The NIA does not believe that this is fair and can lead to unfortunate consequences. These consequences include children pressuring elderly parents to take their benefits as lump sums and pass on these to the children and grand children. It also has the consequence that the sudden death of a person can have ramifications on dependents that do not exist for those who can order their affairs so as to avoid the situation.

The NIA believes that the tax treatment of superannuation death benefits should be consistent and should be tax-free to all. This would also bring it in line with how other assets are dealt with on death.

Recommendation: Superannuation death benefits should be treated consistently in the legislation and that all such benefits should be tax-free no matter whether to a dependent or non-dependent.

Self managed superannuation funds

It was widely acknowledged by NIA members that there were serious implications for people and their SMSFs if their business failed and these people then withdrew funds out of their SMSF to re-establish their business. There was concern about how the Government was going to enforce compliance among the SMSF sector. Given these issues and the current economic and financial turmoil, there were suggestions to ensure that taxpayers were well aware of their obligations and of the comparisons between SMSFs and managed funds. Issues of concern included the fee structure, including rollover fees, exit fees and contribution fees; and the structure of advice to SMSFs and the important role played by accountants.

Recommendation: The Government should continue to ensure that taxpayers are well aware of their obligations surrounding SMSFs and are seeking to obtain appropriate professional advice.

Simplifying the language

It is considered that the *Superannuation Industry Supervision Act (1993)* and Regulations should be written in simpler, plainer language and consideration given to classifying the Act and Regulations in terms of the type of fund. For example, RSE, SAF, SMSF, ADF, PST and so on. A centralised dictionary would also be useful.

Recommendation: In order to educate and better prepare taxpayers for retirement, the Government should consider simplifying the superannuation system and the relevant legislation which is still considered overly-complex.

Fringe Benefits Tax

The most discussed topic among NIA members at the consultation meetings across Australia was FBT and the need for serious reform of Australia's FBT regime. It has become quite obvious that the FBT regime has failed to keep pace with the dramatic changes to the economic and financial landscape since it was first introduced in 1986.

Issues which have been frequently raised include whether fringe benefits should be taxed in the hands of the employee rather than the employer, as was recommended by the 1999 *Review of Business Taxation* (the Ralph Review). The 2006 report *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (the Banks Report) also considered FBT and recommended that the Australian Government should limit reporting of fringe benefits to remuneration benefits only. That is, real business expenses should not be included, such as those relating to business entertainment.

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

One of the major problems referred to in the Banks Report is that the compliance cost associated with FBT is disproportionate to the revenue risk. The Taskforce considered that the reform of FBT should be given priority. It should also be remembered that FBT is not a revenue raising measure but aimed at modifying behaviour.

Whilst NIA members were in unanimous agreement that the FBT system needed serious reform, there was division as to whether or not FBT should be totally abolished. The main reason to remove the FBT regime was the significant and excessive compliance burden imposed by the FBT laws and that it was not worth the revenue collected. There was general support for the proposal that fringe benefits should be taxed but it should be through the income tax system in the hands of the employee rather than having a separate system. Also, that fringe benefits should be taxed at the taxpayer's marginal rate of tax (though some were in favour of penalty rates applying).

There was overwhelming and unanimous support among all members in every state that the FBT year should be aligned with the financial year. It was felt that the original reason of spreading the tax agent's work was no longer relevant.

Other concerns raised by members were that exemptions provided to charities and hospitals do not provide a level playing field whilst others considered these exemptions essential in order for employers in this sector to be able to secure employees. This aspect of the FBT regime requires detailed consideration in any future review.

Definitions in the FBT system can be problematic and confusing. As a result some employers pay for such things as lunch using their own money instead of the company's money due to the difficulties of having to try and determine whether it may be construed as a fringe benefit. For many small business owners or managers it was simply easier to try and reduce the interaction with the FBT system. Many wanted to provide benefits for their staff but found compliance with the FBT laws to be too onerous and felt penalised for 'trying to do the right thing'.

Consideration should also be given to whether the FBT concession for vehicle use should be designed to encourage more environmentally friendly behaviour in that currently, the greater the mileage the greater the concession. This treatment could be reversed.

Recommendation: The Government should undertake a major review of the FBT system.

Capital Gains Tax

According to evidence presented in the 2006 *International Comparison of Australia's Taxes* report (the 'Warburton-Hendy Report'), Australia's CGT regime remains uncompetitive when compared to other OECD countries. Reform should be driven by the benefits which would include greater mobility of capital; greater efficiency of markets especially through the increase in liquidity (asset turnover would increase, presumably to investments with higher rates of return, whether equity or debt investments) and in many cases, greater equity.

One of the initial reforms reflecting these benefits should be a scaled rate of CGT depending on the length of time the asset has been held. There are numerous other issues which affect the efficient operation of the CGT rules including the interactions caused by the small business concessions, even though these have been reviewed in the past, non-resident and trust related issues.

The experience of NIA members is that most clients will always ask what the CGT liability will be and this will affect their decision as to whether to sell an asset, which is in line with the situation described in the Treasury Architecture Paper.

Members also suggested that CGT concessions should be applied equally to all taxpayers despite the structure or entity of the taxpayer.

Recommendation: The Government should consider reforms to CGT including a scaled rate of CGT; and consider improving the operation of the CGT rules.

Reduce complexity

The NIA acknowledges the work of the Tax Design Review Panel to which the NIA made a submission. However, the complexity of the tax system continues to be widely considered as one of the major burdens and impediments for business, with a disproportionate impact on small business. A genuine reduction in the complexity of the tax system would reduce the compliance burden for all taxpayers and the administrative burden for the ATO and government.

A priority should be the finalisation of the rewrite of the tax laws into one Act.

Other suggestions are that more effort should be made to write the tax legislation in simpler, plainer language and that more emphasis should be placed on streamlining definitions and thresholds, as was the case with the small business related changes.

Recommendation: The Government should ensure that ongoing efforts are made to reduce complexity in the tax laws; including finalising the rewrite of the tax laws into a single, streamlined Act.

State taxation

The Government should continue efforts to impose tax reform on the States and Territories, especially in terms of removing indirect taxes such as stamp duty on insurance premiums and business real property transfers; and to achieve harmonisation of taxes including land tax and payroll tax across all States and Territories. We appreciate the work which has already commenced across the States to harmonise payroll tax.

A clear timetable should be set to ensure that the reform process is not stalled and that genuine efforts are made through COAG and other forums to overcome disagreements between the States and Territories and with the Australian Government.

Various state taxes should be abolished like motor vehicle tax which in some states is the highest component of vehicle registration fees. In addition there is general dissatisfaction with how some taxes are collected, for example, those applying to cars (including GST on related transactions) and how there is very little accountability and transparency as to how the numerous taxes which are collected are then returned to taxpayers in terms of improved services. For instance, given the numerous taxes collected relating to vehicles, the roads (especially in NSW) do not appear to reflect the high level of vehicle related taxes.

State taxes and the variations across the States not only lead to unnecessary complexity but also act as a disincentive to overseas businesses to come to Australia. The impact on the decisions of overseas businesses should be considered and measured if possible.

Consideration should also be given to exempt small business from payroll tax which often acts as a disincentive to employ more people.

Despite constitutional obstacles, there was a general feeling among members that Australia did not need three levels of government and that to increase efficiency the state level of government should be removed. Some felt that we were over governed, and that by removing one tier of government, we could reduce costs in terms of the administration of state taxes and other matters.

Another view was that the collection of fees by local governments, such as those collected from developers and rate payers, could be undertaken by state governments or by the federal government, in the same way that the GST is collected and distributed.

Recommendation: There should be a review of the system of State and Territory taxes with the objective of removing, simplifying and streamlining the imposition, collection and distribution of these taxes; and with an emphasis on harmonizing the remaining State and Territory taxes.

ATO to replace State Revenue Offices

In order to reduce duplication and save compliance and administrative costs between the States and between the States and the Commonwealth, the NIA submits that consideration be given to the States referring the administration of their taxation systems to the ATO. The States would retain power over setting the rates and the general policy direction but the day to day administration would be executed by the ATO. It would be a similar situation to the current arrangement under ASIC and the Corporations Act.

Recommendation: In order to increase efficiency and reduce complexity, consideration should be given to the State and Territory governments referring the administration of their tax systems to the ATO.

The transfer system

There was widespread discussion among members about using the transfer system to change the behaviour of taxpayers in order to encourage a greater work ethic and to remove a culture of reliance on the government. Overall, it was considered that the transfer system was too generous and that the Government should consider whether it has gone 'too far' in attempting to be equitable in the distribution of benefits to people (some of whom are not taxpayers). Greater consideration should be given to the accumulated impact of all the transfers rather than just the individual transfer.

Many members held the view that welfare benefits should be paid through Centrelink rather than through the tax system and that a 'netting' process should be applied in order to reduce 'churn'. It was felt that economic efficiency should take priority.

Members also provided comments on affordable housing and how to achieve this goal whilst being mindful of the social consequences, especially the creation of areas of socio-economic disadvantage. Suggestions included linking housing subsidies with employment or education. Incentives could be given to investors to provide not only the housing but also infrastructure surrounding the housing such as play areas.

Examples of transfer payments which were considered too generous include the baby bonus, which many members thought should be removed; however, emphasis should be on keeping the family unit intact. Some members also believed that measures such as the education expense rebate added to the complexity and should be reconsidered.

The issue of maternity leave was considered by members who generally thought that small business will not be able to afford to pay maternity leave and that it will act as a disincentive for employment.

Recommendation: The Government should consider reducing the distribution and level of benefits through the transfer system in order to encourage workforce participation and improve equity for all taxpayers.

Small business tax regime

The NIA is in the process of developing a separate and inclusive small business tax regime. The main feature would be a lower rate of tax (say 20-25 per cent) for small business. Small business could be redefined in terms of meeting two out of three criteria based on turnover, assets and number of employees; alternatively it has been suggested that small business be defined as businesses with turnover of less than $25 million.

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

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

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

Recommendation: The Government should consider an entirely separate, simplified tax regime for small business based on a lower rate of tax.

Company tax

If a reduction in the corporate tax rate is considered on the basis that Australia is losing international competitiveness because of its high overall corporate tax burden, then we suggest that a more economically efficient balance of taxes be considered between taxes on labour, property and capital. The exclusion of the GST is unfortunate as it removes the opportunity to rebalance the mix of taxes and especially given the large contribution GST makes to revenue collection overall.

There was general support among members for a reduction in the corporate tax rate based on building and maintaining international competitiveness.

Recommendation: The Government should re-consider the company tax rate to build and maintain international competitiveness.

The tax system and the environment

One suggestion was to encourage the use of environmentally friendly vehicles including motorcycles and making them exempt from bridge tax/tolls with free parking for motorcycles.

Also, the luxury tax on environmentally friendly vehicles should be removed if the priority is to address the environmental challenges which lie ahead. We acknowledge recent changes announced in this area.

Green taxes

In order to address the potential competitive advantage which might be gained by those countries which do not ratify or comply with the Kyoto Protocol (or its replacement) it has been suggested that certain goods or services which are imported from those countries should be subject to a type of 'green tax'.

Recommendation: The Government should consider a range of concessions to encourage environmentally friendly behaviour by taxpayers.

Optional lodging of tax returns

There was general member support for moving to a system of optional tax returns, which would be expected to be used by PAYG taxpayers with simple tax affairs. The main obstacles were considered to be the use of work related expenses – which could be either removed; capped at a certain amount, say $1,000 – and the Australian culture where obtaining a tax refund is almost considered a 'right'.

We acknowledge the 2008 report by the Joint Committee of Public Accounts and Audit (JCPAA) where this recommendation was made.

Recommendation: The Government should consider making the filing of tax returns optional.

Incentives to invest in new enterprises

Further consideration should be given to developing incentives for investment in new enterprises – similar to deductions on films, aquaculture, race horses and R&D.

Examples include, allowing deductions of 5 per cent to 10 per cent at the time of investment to encourage people to invest in new enterprises and to focus on capital investment upfront rather than on the income. There could be a requirement that the enterprise must operate for a minimum time period of say, one or two years, in order to discourage abuse. It was felt that the Entrepreneurs Tax Offset was conceptually a useful policy but was poorly designed to achieve its objective.

Another suggestion was to increase investment in infrastructure either through concessional depreciation treatment, deductions or infrastructure bonds.

Recommendation: The Government should consider a wider range of incentives to encourage the establishment and sustainability of new businesses.

Luxury Car Tax

It was generally considered that the luxury car tax (LCT) was too high and some thought it should be no more than 25 per cent. However, many members thought it should be abolished altogether as being inequitable and adding to complexity.

Changes to the LCT rate have resulted in contracts having to be re-written possibly with a consequent refund of stamp duty. It was generally considered that LCT was an example of a law that was being changed without due regard to the compliance costs imposed by implementing the changes.

The recent changes to the LCT which provide for exemptions for certain sectors simply add more complexity to the system, reduce efficiency and are not necessarily equitable. For example, if you are a farmer you don't pay LCT but if you work for a farmer and don't own farm land then you are subject to LCT. If the LCT is retained then it should be simplified. We suggest that:

- vehicles worth $70,000 to $100,000 be subject to 10 per cent LCT; and
- vehicles worth $100,000 and above are subject to 30 per cent LCT.

Recommendation: The Government should either remove the LCT or reduce the applicable rate.

Broaden the tax base

It would be preferable to have a broad based tax system where exceptions and exemptions being made to fundamental principles can be avoided. At the very least, exceptions should be used sparingly and limited to truly exceptional circumstances. This would help to reduce complexity and increase equity. In many cases, exceptions were considered by members as benefiting only a small section of taxpayers and therefore were inequitable. These particular people could possibly be assisted in other ways outside the tax system and in a more targeted way.

Recommendation: The Government should seek to broaden the tax base and increase efforts to remove or reduce the use of exceptions and exemptions in the tax laws.

Remove retrospectivity

Retrospectivity of legislation was considered by members as leading to uncertainty which was counter-productive as it often impacted negatively on investment decisions. There was overwhelming support to remove all forms of retrospectivity from legislation and implementation where it did not benefit taxpayers.

Recommendation: The Government should not permit any tax laws to operate retrospectively except if it benefits taxpayers.

Interest on bank deposits

There was general support among members that taxation of interest on deposits in banks and other financial institutions should be removed as a way of encouraging savings. Alternatively, some members supported taxing interest at source, which would be especially useful if Australia moved to a system of optional tax returns.

The global financial crisis has highlighted the benefits of improving Australia's savings rate, which has been below world standards and accompanied by high levels of household debt (about 120 per cent of disposable income). Our reliance on foreign savings and foreign debt with the consequent impact on the current account deficit (about 5 per cent of GDP) could be relieved to some extent if domestic savings were encouraged and domestic banks had a greater deposit base from which to draw.

Useful examples can be found in other countries such as the UK where tax-free accounts can be established by taxpayers to encourage savings. The accounts can be transferable between banks, there can be a cap as to how much can be deposited in a year and there are limitations on withdrawals so that an early withdrawal will result in the loss of tax-free status with the interest on the whole account then being taxable. Another tax-free account could be established for the purpose of investing, say in equities or other asset classes.

Recommendation: The Government should remove the taxation of interest on funds held in bank accounts and other financial institutions.

Harmonising taxes

Given the fact presented in the Architecture paper that the top 10 biggest taxes produce 90 per cent of the income, it was felt by many members that there was obviously scope to either reduce the number of taxes or streamline and simplify the other 115 plus taxes. A concerted effort should be made to reduce the number of taxes. Though it is not part of the terms of reference of the Review, many members felt that an increase in the GST might be warranted to offset any loss in revenue as a result of removing some of the myriad of taxes. The reduction in compliance costs, especially for small business, would be very welcome by members. It was felt that greater emphasis should be placed on increasing economic efficiency.

Recommendation: The Government should attempt to remove most of the inefficient taxes according to their compliance burden and the amount of revenue collected.

Administration of the tax system

It was considered that implementation of the tax system is just as crucial as the legislation and economic structure of the tax system. The current global financial and economic climate would make implementation of any changes more difficult given the further uncertainty and upheaval it would create.

It was generally considered that the ATO should take a more realistic and commercial approach to dealing with tax practitioners and their clients. One view which was widely held was that the ATO acted more like a business trying to meet budget targets rather than being part of the public service, whose purpose was to administer the law effectively for the benefit of taxpayers. The example of allowing greater flexibility around lodgment deadlines for tax practitioners was a common example. Other examples included dealing with constant changes in staff and the inconsistency in responses from staff.

One suggestion for change is that the ATO should inform small business immediately once they incurred a tax liability and there should be no retrospective penalties. These measures would greatly reduce the tax burden on small businesses, many of which try to 'do the right thing'.

The NIA made a submission and provided evidence to the JCPAA inquiry into tax administration and acknowledges and supports many of the recommendations which were made.

Members have also pointed to the role of other government agencies including the Child Support Agency and Centrelink both of which are considered as lacking in transparency and in need of a general review of their processes.

Members have also advised that accountants find it either extremely difficult or cannot open a client trust account, that is, an account similar to a lawyer's trust account.

*Recommendation: The administration of the tax system should be improved by the ATO g*iving greater weight to flexibility and commercial reality.

Use of technology

The use of technology can play a greater part in reducing compliance costs. Examples such as Standard Business Reporting and pre-filling can make a valuable contribution if carried out successfully. However, major changes and the perceptions around them create uncertainty and should be managed more effectively.

Recommendation: The Government should encourage the use of technology in the tax system as a means of reducing compliance costs.

Tax and accounting standards

A review should take place regarding the areas where accounting standards and taxation link together. The Government should consider the distortion that can be created if one set of rules (taxation) is dependent on the answers delivered by another (accounting standards).

The move to International Financial Reporting Standards (IFRS) highlighted this problem because there were intangible assets that companies revalued. These numbers were used for thin capitalisation purposes. The minute IFRS became effective some of these assets were either written off completely or revaluations were discarded because IFRS has specific rules surrounding the recognition of intangible assets.

This meant that large companies in Australia were faced with thin capitalisation problems. The NTLG sub-committee on IFRS issues considered this at the time.

It is preferable that the two regimes are treated separately so that taxation matters do not drive financial reporting and vice-versa.

Recommendation: That the Government undertakes a review of the interaction between the tax system and accounting standards to ensure there are no unintended consequences.

Demutualisations

With respect to demutualisations there was general agreement that there should be no CGT liability and that CGT should only be paid on sale; there was also the suggestion that it should be tax-free.

Recommendation: Demutualisations should not be subject to CGT or only upon sale of the asset.

Business Coalition for Tax Reform

The NIA is a member of the Business Coalition for Tax Reform and supports the recommendations and comments contained in its submission to the Review Panel.

Tax Zone Rebates

The NIA supports the recommendations contained in the submission to the Review Panel by Lex Fullarton (NIA member) on the subject of tax zone rebates.

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