

Dr Ken Henry
Chairman
Australia's Future Tax System Review Panel
The Treasury
Langton Crescent
PARKES ACT 2600

17 October 2008

Dear Dr Henry

We enclose PricewaterhouseCoopers' submission to Australia's Future Tax System Review of Australia's tax and transfer system. Our submission focuses on the issues which we believe are of most importance to the design of a taxation system.

We believe that a successful and achievable outcome for the Review is the design of a world class system of taxation (including globally competitive rates of taxation), that will underpin the economic and social prosperity of Australia for the foreseeable future.

Our approach in preparing this submission

At this early stage of the review process, and in keeping with the approach adopted in Treasury's *Architecture of Australia's tax and transfer system* paper (August 2008), our submission seeks to highlight the problems we believe should be addressed by the Review Panel, and to identify possible approaches to reform. The major challenges are set out in the accompanying Report, with more specific tax reform issues contained in an Appendix.

PricewaterhouseCoopers and our contribution to the debate

PricewaterhouseCoopers' client base is comprised primarily of large to medium sized businesses (many of which have cross-border operations), emerging private groups, high wealth individuals and expatriate employees.

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Our comments and perspectives in relation to tax reform and this submission, concentrate on those issues where we believe our experience allows us to provide practical insight and perspective. Accordingly we have not sought to address all aspects of the Panel's terms of reference. In particular we have provided limited comment on reforms in relation to the transfer system.

PricewaterhouseCoopers consents to making this submission available to the public on the Panel's website, and looks forward to a continuing involvement in the important work of the Panel.

Key contact

The main PricewaterhouseCoopers contact for both this submission and future input to the Panel's work is Tim Cox. Tim can be contacted on (03) 8603 6181 or via email, tim.cox@au.pwc.com.

Yours faithfully



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Submission

Australia's Future Tax System Review

17 October 2008

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Executive summary

This submission seeks to provide input to the Australia's Future Tax System (AFTS) Review Panel as part of its review of Australia's tax and transfer system.

The submission focuses on the issues PricewaterhouseCoopers believe are of most importance to the design of a world class system of taxation (including globally competitive rates of taxation) that will underpin the economic and social prosperity of Australia for the foreseeable future.

The comments and perspectives in this submission concentrate on those issues where PricewaterhouseCoopers believes our experience enables us to provide practical insight and perspective. Accordingly we have not sought to address all aspects of the Review Panel's terms of reference. In particular we provide limited comment on reforms in relation to the transfer system.

Our key recommendations are as follows:

- Even though the AFTS's Terms of Reference excludes GST, the Review Panel should endeavour to reform the taxation system so that there is less reliance on income taxation and greater reliance on consumption-like indirect taxes.
- The overall rate of tax (particularly income tax) should be reduced and the system(s) imposing tax refined to a world class standard to make it relatively easy and competitive to do business in this country.
- In reducing the overall tax impact on business, we believe that the Review Panel should be focussed on ensuring the maximum reduction in the corporate tax rate rather than narrowing the base of taxation.
- Consideration should be given to other mechanisms beyond superannuation to encourage savings and investment.
- The number of taxes imposed by all Australian governments needs to be significantly reduced.
- The process of eliminating inefficient State taxes is far from complete, and needs to be re-invigorated.
- Harmonisation of the remaining State taxes should be a key priority.
- A robust compliance cost reporting mechanism should be a feature of new tax law – at the design, implementation and administration phases.
- Tax collection by one national taxing agency, replacing the various Offices of State Revenue, would radically improve the efficiency of the current process.

- PricewaterhouseCoopers supports consideration of ways in which audited entities can make greater use of their financial reports for income tax purposes.
- Consideration should be given to reducing the number of individual taxpayers (particularly employees) who need to lodge a taxation return, and simplifying the experience of those who continue to lodge taxation returns.
- The re-write of the Income Tax Assessment Act 1936 should be completed so that Australia has one income tax act.
- The use of the taxation system as the delivery mechanism for welfare payments needs to be re-considered.

For further detail please contact Tim Cox, Partner, on (03) 8603 6181 or via email, tim.cox@au.pwc.com.

The key challenges for Australia's tax and transfer system

The key challenges facing Australia's Tax Transfer System have been well documented in a number of recent submissions and Government sponsored reports¹.

As noted by the BCA and others, taxation is integral to Australia's economic and social framework, and reform of the current taxation system is critical if we are to meet a range of key challenges.

We set out below our preferred approaches to tackle the main challenges for Australia's taxation system.

The role of the taxation system

At a most basic level, the taxation system's principal role is to raise sufficient revenue to support Government functions and services. As illustrated in the AATTS however², in recent years there has been a rapid increase in the range of tax concessions ("tax expenditures") provided through the tax transfer system.

Aside from the fact that such concessions have created complexity, added to compliance costs, and resulted in "winners and losers" within the taxpayer community, they raise more fundamental questions, such as:

- Is the taxation system the appropriate delivery mechanism, rather than, for example, targeted payments?
- Does the taxation system provide Government with a transparent mechanism to assess whether the desired policy outcomes are being achieved?

If the Government is to achieve lasting, fundamental taxation reform, the Panel should preface its recommendations with a clear statement regarding the role of the taxation system. This will ensure future tax policy design and implementation can be framed by reference to a benchmark which clearly explains the role of the taxation system in a modern, efficient society.

The tax mix

The AATTS document notes Australia's over-reliance on income taxation, as distinct from indirect taxes, and particularly consumption taxes³. This is of particular concern given the changing demographic profile of the Australian community.

¹ These include: BCA, CTA and PricewaterhouseCoopers, *Tax Nation: Business Taxes and the Federal-State Divide*; BCA, *A Better Tax Return*.

² AATTS, para 2.6, page 32-34.

³ AATTS, page xvii.

Moreover, although heavy reliance on income taxes during a strong economic environment might meet government revenue needs, more difficult economic times will place challenges on maintaining government revenue and hence the provision of services if the taxation system is unnecessarily reliant on income tax, particularly from large business.

Even though the Panel's Terms of Reference excludes GST, our view is that **the Panel should endeavour to reform the taxation system so that there is less reliance on income taxation and greater reliance on consumption-like indirect taxes.**

We note the Federal Government's decision to exclude GST (the only Federal tax "ear-marked" for the States) from the scope of the Panel's review. We believe this exclusion will unfortunately limit the ability to properly address the system's many structural issues. We also note that **the option of ear-marking a proportion of income tax collections to the States** has received favourable comment recently⁴, and this **should be considered by the Panel.**

Maintaining Australia's competitiveness in the global economy

The AFTS Review needs to enhance our long term competitiveness, across the full range of business activity. The Federal Government has already made some progress in this regard with its recent initiatives to enhance Australia's attractiveness as a regional financial centre⁵. Nonetheless, much more needs to be done to make the taxation system a positive aspect of doing business in Australia.

Although there may be scepticism in some quarters about the role taxation plays in investment decisions by business, our experience indicates that tax is one of the key factors impacting the strategic decisions of:

- Australian companies as to where they locate assets, functions and risks⁶, or indeed the location of their corporate headquarters.
- Foreign companies as to where they invest and locate their operations⁷.

⁴ Senate Select Committee on State Government Financial Management 2008, *Report on Commonwealth and State and Territory Fiscal Relations and State and Territory Government Financial Management*, Canberra.

⁵ Address by the Hon. Craig Emerson MP, "Financial Centres for the Future", conference organised by the Melbourne Centre for Financial Studies, The Park Hyatt Melbourne 20 May 2008. Address by the Hon. Chris Bowen MP at the Investment and Financial Services Association (IFSA) Member Lunch, February 2008.

⁶ The ATO is also aware of such structuring arrangements: refer Commissioner of Taxation, 2008 Compliance Program, page 42

⁷ On 29 April 2008, the Chancellor of the Exchequer, Alistair Darling, announced the creation of a forum to discuss the long-term competitive challenges facing the UK Government and business: refer http://www.hm-treasury.gov.uk/press_4208.htm. The announcement followed decisions by a number of leading UK companies to relocate their headquarters to Ireland for tax reasons.

We believe both the overall rate of tax (particularly income tax) and the system(s) imposing tax, have significant influence over the choices business makes. Consequently, Australia should have a competitive rate of taxation within an overall system of taxation, that makes it relatively easy to do business in this country. Indeed we believe the AFTS Review Panel should be seeking to design a world class system of taxation.

AATTS confirms our statutory corporate tax rate is now above the OECD average. This relative position is getting worse, with two other countries (New Zealand and Canada) proposing reductions in their tax rate, after which Australia will have the equal 6th highest rate in the OECD.

Recent economic events have reinforced the shifts in global economic power and the increasing importance of countries outside the OECD. In gauging the impact of the company tax rate on Australia's competitive position, regard should also be had to non-OECD member countries, particularly those in our region.

The effective tax rate

Although the headline company tax rate attracts most attention in competitive analysis, we urge the Panel to also consider the *effective* tax rate faced by Australian business taxpayers. The effective rate is normally defined as income tax expense stated as a percentage of profit before tax, and accordingly takes account of legislative factors which determine the taxable income or tax base.

A recent study by PricewaterhouseCoopers for the BCA and CTA⁸ indicates Australia's effective rate of tax of ASX listed companies, with predominantly Australian businesses, was 29.3% (median) and 27.6% (average) in 2007. This study also shows that, in stark comparison with other countries⁹, there is a comparatively small differential between the statutory and effective company tax rates in Australia. This indicates a significantly broader tax base in Australia than in these other countries; this is irrespective of whether the statutory rate is more or less than that in Australia.

Not only is Australia's statutory company income tax rate of tax increasingly uncompetitive internationally, our analysis shows that our effective tax rate is even more uncompetitive. This is not to say that Australia should seek to have the lowest rate of taxation. Nevertheless, we believe there is an increasingly strong case to argue the overall income tax impost on business needs to be reduced.

The question is how a reduction in the income tax burden on business is best achieved. There will no doubt be many submissions arguing for various incentives or preferences, which would have the effect of narrowing the tax base.

⁸ BCA, CTA and PricewaterhouseCoopers, August 2008, *Review of the Effective Tax rates in Australia* (unpublished).

⁹ United Kingdom, Germany, Singapore, Canada and the United States of America.

Many of these will have substantial merit, although they may impact various sectors of the economy differently, with any reforms inevitably creating “winners and losers”. We assume narrowing of the tax base would limit the ability to reduce the statutory rate by as much as would otherwise be the case. **In reducing the overall tax impost on business, we believe that the Review Panel should be focussed on ensuring the maximum reduction in the corporate tax rate.**

We believe Australia’s corporate income taxation rules have evolved into a reasonably sound regime, which does not necessarily require significant overhaul. Most of our concerns relate to the detailed design and administration of the corporate income tax rather than its fundamental objectives.

We set out in an Appendix some specific suggestions in relation to our existing laws that we believe warrant attention.

Using the taxation system to more effectively encourage savings and investment

A range of factors, particularly the escalating demand for government, provided services resulting from inter-generational factors¹⁰, support moves to a more favourable tax regime on savings and investment. Superannuation concessions have gone some way to achieving this, but **consideration should also be given to other mechanisms to encourage savings and investment.** For example, a dual tax regime with low PAYG withholding on interest and unfranked dividend payments is worthy of consideration provided the withholding obligations on payers are kept simple. Such a regime would also support possible removal of tax return lodgement obligations for a significant proportion of individual taxpayers (see below).

The dividend imputation system

We acknowledge the comments in the AATTS document relating to the dividend imputation system¹¹, and its uniqueness in a global tax context. No doubt the Panel will receive submissions both for and against the current regime, reflecting in part the different perspectives of international and domestic investors. We note that any change to the current dividend imputation rules will need to be carefully thought through, particularly in light of the role that franking credits play in:

- reducing the double taxation of company profits, and
- encouraging direct and indirect equity investment in Australian companies.

¹⁰ Treasury *Intergenerational Report 2007*, Canberra; Productivity Commission 2005, *Economic Implications of an Aging Australia*, Research Report, Canberra.

¹¹ AATTS, pages 262-264.

Given that Australia and New Zealand have broadly equivalent imputation systems, and the move to closer economic relations between the two countries, **mutual recognition of trans-Tasman franking credits should be considered** by the Review Panel¹². This aspect will be the subject of a separate submission by PricewaterhouseCoopers on behalf of a number of trans-Tasman companies.

Reducing the number of taxes and reforming the tax collection process in Australia

AATTS notes that there are at least 125 taxes paid by Australians. Of the tax total revenue raised by Australian governments in 2007, 90% was derived from just 10 taxes. Accordingly, the remaining 115 taxes raise only 10% of tax revenue.

Exactly the same issue exists for business with 56 Federal, State and Local government taxes, borne or collected by companies. Of these taxes, 5 taxes raised about 90% of all taxes borne or collected¹³. This contrasts with the United Kingdom which imposes 22 taxes on business.

The number of taxes imposed by Australian governments needs to be significantly reduced. We would like to see the AFTS Review at least halve the number of taxes imposed on Australian taxpayers. This rationalisation of the number of taxes should be undertaken irrespective of any decisions to reduce the overall taxation impost. These small and often inefficient taxes should be abolished, even if all or part of the revenue they raise needs to be replaced by increases in the remaining taxes.

State taxes – unfinished business

The number of taxes and the need to deal with multiple tax collection agencies has resulted in complexity, inefficiency and an enormous compliance burden for Australian taxpayers, particularly those in the business community¹⁴. Despite some progress on State taxation reform as a result of the introduction of GST, **the process of eliminating inefficient State taxes is far from complete, and needs to be re-invigorated.**

State purchaser transfer duties are particularly inefficient: they distort investment decisions and produce unreliable revenue streams¹⁵. Insurance duties and fire services funding arrangements also rank poorly on a number of criteria.

¹² Refer PricewaterhouseCoopers submission to Treasury on mutual recognition of trans-Tasman imputation credits.

¹³ BCA, CTA and PricewaterhouseCoopers, *Tax Nation: Business Taxes and the Federal-State Divide*, and *What is your Total Tax Contribution? 2007*.

¹⁴ BCA, CTA and PricewaterhouseCoopers, *Tax Nation: Business Taxes and the Federal-State Divide*.

¹⁵ Independent Pricing and regulatory Tribunal, *Review of State Taxation. Draft Report*. June 2008 Sydney.

Land tax and payroll tax, although opposed by a range of business and industry groups, appear to be the most efficient State taxes¹⁶ and, assuming they are retained, consideration should be given to broadening the tax base and lowering the rate for these taxes.

Many State taxes are levied on essentially similar transactions with little consistency across jurisdictions. **Harmonisation of remaining State taxes should be a key priority**, with recent reforms to payroll tax showing what can be achieved. Such harmonisation should focus on a consistent approach towards the tax base, tax calculation and tax collection; the tax rate and exemption thresholds should remain an opportunity for competition between the States.

Federal State relationships

Because of the current vertical fiscal imbalance between Federal and State governments, progress on these State tax reform challenges will be difficult without a broad review of Federal-State:

- responsibilities for the delivery of services, and
- revenue sharing arrangements.

Further reforms are needed to the way in which the Commonwealth Government funds or purchases key services (eg public hospitals, schools and housing) from the States.

Recent reforms by the Federal Government have focused on rationalising the number of specific purpose payments so as to reduce transaction costs and improve State funding certainty. Whilst these changes have some merit, there may also be efficiency benefits in moving away from lump sum funding to a more sophisticated model which the Commonwealth purchases services from the States on a per unit basis, with the unit price levels linked to quality and reliability performance criteria.

At present the States have high variability in service quality and no clear funding incentives to efficiently match demand to capacity. The States are also typically slow to adapt the operating locations of their public hospitals, schools and housing services to meet changing market needs. An efficient economy requires greater flexibility and mobility in its resource allocation with incentives to exceed minimum quality criteria.

¹⁶ Independent Pricing and regulatory Tribunal, *Review of State Taxation. Draft Report*. June 2008 Sydney.

Reducing compliance costs

Taxation compliance costs in Australia are an issue for both taxpayers and Government. These costs are a feature of any taxation system, but are exacerbated by the number of taxes, and their complexity, in Australia.

Compliance costs are most obviously reflected in the size of in-house tax functions for large business and the use of tax agent and professional adviser services more generally. In addition there are a range of hidden costs, such as record-keeping and compliance with Revenue authority administrative requirements. These are often embedded in systems and other business overheads (“shadow tax function”).

Equally from a Government perspective, tax collection agencies have significant human resource requirements and spending on infrastructure and technology.

What are the compliance costs?

PricewaterhouseCoopers' Total Tax Contribution surveys have provided empirical evidence on the cost of paying and collecting taxes for business¹⁷.

Australia lacks comprehensive data on taxation compliance costs, and **a robust compliance cost reporting mechanism should be a feature of all new tax law – at the design, implementation and administration phases.**

A national tax collection agency

Combined with a rationalisation of inefficient taxes, **tax collection by one national taxing agency**, replacing the various State OSRs, **would radically improve the efficiency of the current process for both business and Governments.** The collection of GST by the ATO on behalf of the States provides a useful model which should be considered in the context of other taxes. As noted above, harmonisation of the State taxes base would enhance the compliance cost savings. Centralisation would also deliver scale benefits, such as:

- lower tax collection costs,
- greater use of electronic reporting of tax data, and of electronic payment / refund arrangements,
- streamlined tax reporting, and
- streamlined statistical collection.

¹⁷ BCA, CTA and PricewaterhouseCoopers, *Tax Nation: Business Taxes and the Federal-State Divide*, and *What is your Total Tax Contribution? 2007*.

Greater use of accounts as the basis of tax calculations by large and widely held entities

PricewaterhouseCoopers supports consideration of ways in which audited entities can make greater use of their financial reports for income tax purposes. There is already a trend to better align taxation and accounting in some parts of the law (eg the proposed Taxation of Financial Arrangements Stage 3 and 4 measures) and further consideration should be given to additional areas where similar compliance cost savings may be achieved.

The need for individual tax returns

We endorse the recent JCPAA recommendation that **consideration be given to reducing the number of individual taxpayers (particularly employees) who need to lodge a tax return, and simplifying the experience of those who would continue to lodge returns**¹⁸. It is noted that this will involve reconsideration of the role of the taxation system in delivering benefits and offsets and the removal of a range of personal deductions.

For those taxpayers who are still required to lodge tax returns, additional opportunities to provide pre-filled tax returned data should be investigated.

One Income Tax Assessment Act

In implementing the Panel's recommendations, **the Government should commit to completing the re-write of the ITAA 1936 so that Australia has one income tax assessment Act.**

Legislative design

The design of tax law needs to be improved in various respects, including:

- ensuring policy considerations are better reflected in the drafting process,
- the “drag net” mind-set to the design of parts of the existing tax provisions should be reviewed (see comments in the Appendix regarding FBT), and
- the “chase every cent” approach needs to be tempered. Although often justified as specific anti-avoidance measures, many are considered to be unnecessary in view of the general anti-avoidance provisions.

¹⁸ JCPAA 2008, *Inquiry reviewing a range of taxation issues within Australia*, Canberra. Refer Recommendation 7, page 86,

Better tax design

In terms of on-going improvements to the design and implementation of new tax laws, we endorse the recommendations contained in the Tax Design Review Panel's report *Better Tax Design and Implementation*¹⁹.

The taxation system should support, not hinder, the Government's policies on climate change

Climate change is a key challenge facing Australia and the rest of the world. Although tax plays a comparatively small role in the broad range of policy responses from the Federal Government, it is obviously desirable that the taxation system not hinder the impetus required to reduce carbon emissions.

PricewaterhouseCoopers and the CTA have lodged a joint submission²⁰ in response to the Government Department of Climate Change Green Paper on the Carbon Pollution reduction Scheme. The submission contains comments on relevant tax-related issues which the AFTS Review Panel may wish to also consider.

Improving labour force participation, encouraging the acquisition of skills, encouraging skilled labour to remain in Australia, and encouraging skilled labour to relocate to Australia

At a time when there is a shortage of skilled resources, last year 158,000 highly educated Australians sought work opportunities overseas. This figure has more than doubled over the last two decades.

Employee share ownership

The taxation system should continue to encourage employee share ownership. The benefits of such arrangements extend far beyond tax, including areas such as performance improvement and industrial relations.

The design of Australia's employee share scheme rules should be reviewed to ascertain whether current arrangements:

- are comparable with OECD countries (ie in terms of international competitiveness), and

¹⁹ Tax Design Review Panel, *Better Tax Design and Implementation. A Report to the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs*, 30 April 2008 (released on 22 August 2008). Treasury website, Canberra.

²⁰ PricewaterhouseCoopers and CTA, *Carbon Pollution Reduction Scheme Green Paper Submission*, September 2008.

- can be made both more practical for business owners and employees (eg the interaction between the ordinary income and CGT provisions).

Personal tax rates

The personal income tax rate scale for low income earners (and related welfare payment withdrawal arrangements) needs to encourage greater workforce participation. It is clear from the Panel's Terms of Reference that the interaction between the personal tax rate scales and the withdrawal effects of Government support payments will be a key focus area.

PricewaterhouseCoopers supports the Federal Government's aspirational goals for personal income tax rate reductions²¹.

Australia and the global labour market

The existing range of income tax and superannuation concessions for temporary residents, and for Australian residents working overseas, should be retained and enhanced (see Appendix).

Skill development

The Review Panel should review whether any improvements are needed to the way in which the Higher Education Contribution Scheme (HECs) is imposed and administered.

In an environment where personal tax returns need not be lodged by the many individual taxpayers, we note that this will result in:

- the loss of deductions for self-education expenses, and
- the Government's proposed education tax refund would need to be reconfigured as a grant.

The Review Panel should address the need for compensating post-graduate study grants or fee relief mechanisms (particularly for occupations where acknowledged skill shortages exist).

We do not favour use of the taxation system to encourage training²². Training provided by business taxpayers is (and should remain) deductible for tax purposes. Rather than imposing a "levy" on business, direct Government grants and funding measures should be pursued, as well as reforms to the broader workplace framework which encourage workplace training programs²³.

²¹ The goal is to have three tax rates by 2013/14 – 40%, 30% and 15%. Australian Labor Party, *A Tax Plan for Australia's Future*, 18 October 2007. Source: www.alp.org.au

²² Readers may recall the short-lived Training Guarantee Levy arrangements which applied from 1990 to 1994.

²³ The Federal Government's Trade Training Centres in Schools Plan is an example of this preferred approach.

Supporting low income individuals and low income families, but via greater emphasis on targeted means tested grants, rather than generally available income tax offsets

The AFTS Review Panel's Terms of Reference make clear that it will address the complexity and compliance costs arising under the current tax transfer and social welfare systems.

We note that there is a lack of uniformity as to whether benefits are linked to family or individual circumstances and income. A simplified, whole of Government approach to determining eligibility is needed.

The use of the taxation system as the delivery mechanism for welfare payments also needs to be re-considered in light of:

- ATO collection costs,
- the cost of obtaining tax agent assistance,
- the complexity and “churn” associated with the current approach (eg Family Tax Benefit, dependant tax offsets), and
- the possible removal of tax return lodgement obligations for the majority of individual taxpayers.

Targeted means tested payments could be the preferred delivery method using a central agency such as Centrelink.

Appendix

Capital management

- Standard capital management strategies for Australian companies are unnecessarily cumbersome because of a number of tax avoidance rules (including capital and dividend streaming, section 45B). At present, normal capital management and restructuring transactions are being delayed pending ATO class rulings.

We acknowledge this issue will partly be addressed by the Board of Taxation's recently completed review of off-market share buy backs, which is currently being considered by the Treasurer. It is important that the law can provide sufficient certainty for business to undertake these type of transactions without ATO clearance.

Company losses

- The Panel should consider the desirability of flow-through loss shares for companies engaged in certain sectors, such as:
 - mining,
 - oil and gas,
 - renewable energy (reflecting the Government's climate change policies), and
 - high tech development companies.

The main supporting considerations are as follows²⁴:

- international competitiveness, particularly with resource rich nations such as Canada,
- attracting equity investment in such companies,
- Australia's national interest in continuing to encourage investment in these sectors, and
- utilisation of tax incentives available at the corporate level by investors at risk, rather than having the losses which result from those incentives jeopardized by company loss carry forward tests (eg change of ownership test).

We recommend that flow-through loss shares be considered, drawing on existing tax models in other countries, eg United States "S" Corp. New Zealand limited liability loss companies.

²⁴ Minerals Exploration Action Agenda, *The Road to Discovery*, 2 July 2004 (http://www.ret.gov.au/resources/industry_consultation/minerals_exploration_action_agenda/Pages/MineralsExplorationActionAgenda.aspx); *Minerals Council of Australia, 2007-08 Pre-Budget Submission*, <http://www.minerals.org.au/economics/publications>

- Loss carry back rules should also be considered as part of the Panel's review for reasons which include:
 - international competitiveness vis-à-vis other jurisdictions (eg the United Kingdom, USA) where this facility is available²⁵, and
 - the incentive it provides to key industries (such as the mining, oil and gas sectors) which face high decommissioning and other wind-down costs.

A streamlined regime for the taxation of trusts

- The Board of Taxation is currently undertaking a *Review of the tax arrangements applying to managed investment trusts*²⁶. It is envisaged that the Board's report will contain options for introducing a specific tax regime for managed investment trusts. Although there are no specific details, a move to a specific regime has broad in-principle support.

The Panel should:

- await the outcome of the current Board of Taxation *Review of the tax arrangements applying to managed investment trusts*, and
 - if considered appropriate, incorporate the Board's recommendations into the overall re-design of the tax law applicable to trusts (see below).
- The general income tax rules relating to trusts in Division 6 ITAA 1936 have not yet been reviewed as part of the tax law simplification project. The relevant tax law is complex, and difficult to apply.

Trusts play an important commercial role, particularly in private groups, for example, for asset protection and family succession.

However, there is an opportunity to streamline, simplify and link related tax concepts in the legislation, eg aligning the definition of income and net income in Section 95 to taxable income, family trust elections, trust loss rules, ultimate beneficiary non-disclosure rules, transferor trusts, foreign investment fund, and the flow-through of imputation credits.

We suggest the Panel establish a working party of private sector professionals, ATO and Treasury officials to re-design and re-write the income tax rules applicable to "general" trusts.

- For nominee arrangements, bare trusts and trusts where there is an absolutely entitled beneficiary, the income tax law should adopt a consistent approach and treat the asset or interest as that of the beneficiary. Recent ATO interpretations in the context of foreign source dividends have cast doubt on this – refer TD 2008/25.

²⁵ Refer Chapter 5, R Warburton and P Hendy, *International Comparison of Australia's Taxes*, Canberra April 2006. The report found that half of the so-called "OECD-10" comparison countries permit loss carry back.

²⁶ Hon Chris Bowen MP, Media Release No 10, 22 February 2008.

Maintaining the transparent treatment of partnerships

- Although the tax treatment of general partnerships is relatively straightforward, there have been a number of recent instances where, according to the ATO, concessional tax treatment does not “flow-through” this type of structure. For example, see TD 2008/23 and TD 2008/24 relating to the flow-through of foreign source capital gains and foreign source dividends.

We submit that the law should be amended to make clear that a general partnership is a transparent entity for all purposes of the tax law.

Further simplification of the superannuation tax regime

- The Simpler Superannuation reforms of the previous Coalition Government provided important improvements to the superannuation tax regime in Australia.

In our view, the Panel should not make major changes to the new regime. Rather, it should take the opportunity to review the impact and operation of the new rules to see whether it could be further simplified.

- For example, the rules relating to superannuation contributions could be further simplified. Now that there is an effective cap on concessional (tax deductible) contributions, the need for the 10% employment income test is unclear.
- There is currently unnecessary complexity and monetary limits placed on the roll-over of foreign superannuation funds into an Australian fund when a person becomes an Australian tax resident. We recommend that this limitation be removed even if such relief was limited to roll-overs from comparable tax countries where there are appropriately regulated superfund tax regimes, eg United States 401k funds.

A review of small business concessions

- Small business entities are eligible for a range of capital gains tax concessions²⁷. These concessions have grown over the years. The review provides an opportunity to assess:
 - small business concessions should be rationalised,
 - the complexity of the eligibility criteria, and
 - whether a separate small business tax regime should be established to reduce the complexity of the main body of tax law, whilst creating a single comprehensive tax code for small business.

²⁷ AATTS, page 259, Box 8.3. See also *Treasury statement 1411*, issued on 14 October 2008, containing draft legislation on small business measures announced in the 2008-09 Federal Budget.

- We note that an entity flow-through tax regime proposes entities be treated like a partnership for tax purposes with owners taxed at their marginal rates. This proposal has already been referred to the Panel²⁸ and is worthy of consideration.

Taxation of offshore entities

- We note that the Board of Taxation is currently examining the following areas as part of its review of the anti-tax-deferral regimes²⁹:
 - "Modernisation" of the controlled foreign company (CFC) and foreign investment fund (FIF) rules - including a new definition of passive income for the purposes of the accruals taxation regime to ensure that there is no accruals taxation of what is active business income, new exemptions, and more ways to calculate attributable income, and
 - Consistent treatment of superannuation entity investment offshore whether it is through a controlled entity, flow-through entity, or direct investment.

We urge the Panel to give favourable consideration to the Board's recommendations.

- The law regarding the treatment of foreign trusts (whether controlled or uncontrolled) needs to be simpler as determining the appropriate treatment under current law involves substantial compliance costs

This has been a long-standing issue of concern, and one flagged for reform by the previous Coalition Government³⁰.

The Board of Taxation is to some extent currently looking at this in the context of the transferor trust rules, but further impetus for reform from the Panel would be most welcome.

Capital allowance review

- The Panel will no doubt receive input from particular industry sectors regarding the rates of depreciation on depreciating assets published by the ATO.

Although taxpayers have an opportunity to self-assess the effective life of assets, many taxpayers prefer to stay within the "safe harbour" rates published by the ATO. For these taxpayers, there is a view that:

- the ATO rates are out of date, and
- lobbying for a changed rate can be a lengthy process.

²⁸ Institute of Chartered Accountants and Deloitte, April 2008; *Entity flow-through (EFT) Submission*; Hon Craig Emerson MP; Minister for Small Business Independent Contractors & the Service Economy., Media Release 11 June 2008]

²⁹ The Hon Peter Costello MP, Press Release No 109, 10 October 2006.

³⁰ Hon Peter Costello MP, 2003-2004 Federal Budget Press Release, *Review of International Taxation Arrangements*, 13 May 2003.

According to a 2006 study³¹ Australia's treatment of depreciation was generally less favourable than in comparable OECD countries. It found that Australia has the equal lowest value of depreciation allowances of the OECD-10 countries if the value is measured as the present value of depreciation as a proportion of initial purchase price.

We would support moves to involve an organisation such as the Productivity Commission in the setting of benchmark depreciation rates.

- The need for increased investment in a broad range of Infrastructure assets raises for consideration the current tax and regulatory issues that influence private sector participation in infrastructure development.

Recent tax amendments have helped clarify eligibility for capital allowance deductions, and the panel should seek input on the whether these provisions could be improved.

In terms encouraging greater investment, the suitability of current write-off rates applicable to infrastructure assets should also be reviewed.

- The amortization of goodwill will no doubt be on the Panel's agenda.

Although such a tax write-off would narrow the tax base, it is relevant for many of our clients who see it as justifiable from a global competitiveness perspective.

Fringe Benefits Tax

- We note that closer alignment of the company tax rate and top personal tax rate will further encourage the "cashing-out" of fringe benefits. Nonetheless, FBT remains an example of a "drag net" tax with high administration costs which produces tax revenue mainly in respect of a small number of benefits. FBT is commonly cited by business as a tax which imposes an administrative burden which is totally disproportionate to the revenue collected.
- Our preferred approach is for FBT to be abolished and for employees to pay tax on the benefit at their marginal rate. The employer would continue to have the obligation of calculating "benefits values" which would be disclosed on the PAYG statement for inclusion in the individual employee's tax return.
- If FBT is to be retained, the Panel should give consideration to a revamped FBT law which would require employers to calculate the taxable value of only the commonly provided benefits (eg company car, low interest loan, private expense reimbursements) which form part of an employee's remuneration. The New Zealand approach to taxation of fringe benefits provides a useful point of reference³². The existing living away from home allowance concessions should be retained. Only specified benefits would appear as "reportable" fringe benefits provided to the ATO for data-matching purposes with other Government agencies.

³¹ R Warburton and P Hendy, *International Comparison of Australia's Taxes*, Canberra April 2006

³² Inland Revenue (New Zealand), *Fringe benefit tax on specific categories of benefits*, Inland Revenue website: <http://www.ird.govt.nz/fbt/categories/>

- In relation to motor vehicles, the Panel should overhaul the FBT “statutory formula” calculation for employer provided motor vehicles to reduce the incentive to drive longer distances to obtain lower FBT outcomes and (as part of a broader policy on climate change) encourage the use of low emission vehicles in business activities. One alternative would be a valuation formula based on the carbon-emission rating of the vehicle (ie the more environmentally efficient, the lower the taxable value). The formula could also include:
 - a reduction in taxable value for business kilometres travelled, and
 - recognition for tolls (paid in cash and using E-tags), to dispense with the record keeping required for low value items.
- In terms of the current FBT law, the Panel should consider:
 - Reducing the complexity of the current income tax and FBT interaction on employee meal entertainment fringe benefits, club memberships, and spouse travel.
 - Expanding the scope of fly-in fly-out concessions to cater for labour shortage and mobility issues confronting an increasing number of Australian employers in an expanding range of industries.
 - The appropriateness of the remote area housing rules, given the onerous compliance costs associated with the current provisions.
 - Exempting airport car parks from the definition of a commercial car park, to avoid car parking fringe benefits arising in outer-suburban locations.
 - Extending FBT return lodgment deadlines to reduce the compliance burden on employers and tax agents.

Personal taxation – resident individuals

- We support the Government's announced aspirational goals for personal income tax rates. In conjunction with a reduced corporate tax rate, the narrowing of the rate differential between personal and company tax rates would further reduce some of the distortions in the taxation system (eg entity selection, salary packaging), and improve the operation of the dividend imputation system.
- As part of the move to a streamlined personal income tax regime, consideration should be given to allowing taxpayers to elect to be taxed on the basis of family income.
- A small annual CGT free allowance should be considered as part of any move to abolish tax returns for individuals with straightforward tax affairs (see above).

Reducing compliance costs for individual non-resident taxpayers

- Consideration should be given to an income tax de minimis rule so that only those individuals working in Australia for a period in excess of, say, 90 days are subject to Australian tax. This would be consistent with the exemption currently afforded to Australian residents employed offshore.
- The superannuation arrangements currently applicable to inbound temporary residents should be reviewed to reduce employer and superannuation fund compliance costs.
- The process for obtaining tax file numbers for inbound workers should be streamlined (eg a TFN could be obtained as part of the work visa application).
- The application of the foreign currency (Division 775) measures to expatriates is unclear, and levels of non-compliance are generally considered to be high. The relevant tax rules should be simplified for individual taxpayers.
- In the context of making Australia an attractive place for global labour, the treatment of superannuation arrangements needs review. There are proposed changes on how temporary visitors are dealt with, and PricewaterhouseCoopers has recently lodged submissions on these measures³³.

A streamlined tax collection process for Australia

- Given the reliance on payers (mainly businesses) to withhold PAYG taxes, existing PAYG withholding rules should be reviewed to reduce the compliance costs associated with:
 - collecting the tax for Government; and
 - reporting to payees.

The heavy sanctions for not withholding, or withholding the incorrect amount, should also be reviewed and alleviated for those businesses who unintentionally fail to meet their obligations.

- Although GST is outside the scope of the Panel's Terms of Reference, we urge the Panel to take note of business concerns relating to GST administration and collection processes³⁴. Because of the integrated nature of the tax collection process across a range of taxes using the Business Activity Statement, reform of the tax collection process cannot (and should not) be done by isolating GST from the task at hand.

³³ Refer PricewaterhouseCoopers submission to the Senate Economics Committee in relation to its inquiry into the Temporary Residents' Superannuation Legislation Amendment Bill 2008 and the Superannuation (Departing Australia Superannuation Payments Tax) Amendment Bill 2008, together with PricewaterhouseCoopers' original submission to Treasury dated 26 May 2008 (in response to the consultation paper released on 5 May 2008).

³⁴ Productivity Commission Research Report, *Annual Review of Regulatory Burdens on Business: Manufacturing and Distributive Trades*, August 2008 Canberra. Para 8.5.

³⁵ The Hon Chris Bowen MP, Assistant Treasurer, Media Release, 11 June 2008.

The Board of Taxation has been asked to undertake a review of the legal framework for the administration of the GST³⁵, and it is hoped that the Board's recommendations can be taken into account by the Panel as part of a broader examination of the tax collection process.

Tax dispute resolution

- The current tax dispute resolution system imposes substantial compliance costs on taxpayers because the onus of proof is placed on them under the law. Given that a taxation dispute is typically preceded by an ATO investigation and ATO consideration of the merits of the taxpayer's objection, we consider that the Commissioner should be obliged to discharge a prima facie burden of proof in the litigation process. This prima facie case requirement would evidence the fact that the Commissioner has carefully considered the merits and formulated sound reasons for his stance. It would also create a more level playing field in settlement negotiations by reducing the implicit threat of litigation against taxpayers.
- We also believe that taxpayers should be able to seek judicial review of ATO processes and decisions in circumstances beyond those envisaged in the current Part IVC framework in the Tax Administration Act 1953. The recent High Court decision in *Commissioner of Taxation v Futuris Corporation Limited* is an example of the way in which the ATO can avoid judicial scrutiny of its actions. The case illustrates that double taxation is an insufficient basis to get judicial review. Significantly the Full Federal Court thought there should be judicial review but the High Court took a black letter view to the contrary.

ATO public and private ruling procedures

- PricewaterhouseCoopers acknowledges the valuable work undertaken within the ATO in publishing the views of the Commissioner on the interpretation and administration of the various tax laws administered by the organisation.

The proliferation of non-binding statements from the ATO is however causing concern, both within our business and amongst clients. For example, the non-binding status of Law Administration Practice Statements (PSLAs) published in recent times on a number of important topics (buy-backs, Part IVA, litigation) have been highlighted as a concern because of the potential exposure to additional primary tax. Many feel that the ATO's Interpretative Decisions should also be accorded greater "taxpayer protection" status.

This issue is currently under review by the Inspector-General of Taxation³⁶.

³⁶ Inspector General of Taxation, Review into the Tax Office's Administration of Public Binding Advice – Terms of Reference and Consultation Plan, 12 October 2007.

Abbreviated References

<i>AATTS</i>	<i>Architecture of Australia's Tax and Transfer System</i> , Treasury, August 2008 © Commonwealth of Australia
<i>AFTS</i>	Australia's Future Tax System
<i>ATO</i>	Australian Taxation Office
<i>BCA</i>	Business Council of Australia
<i>CTA</i>	Corporate Tax Association
<i>CGT</i>	Capital gains tax, generally applicable to assets acquired or deemed to be acquired after 19 September 1985
<i>FBT</i>	Fringe Benefits Tax
<i>ITAA 1936</i>	Income Tax Assessment Act 1936
<i>ITAA 1997</i>	Income Tax Assessment Act 1997
<i>JCPAA</i>	Joint Committee of Public Accounts and Audit
<i>OSR</i>	Office of State Revenue – used here as a generic reference to the various State tax collection authorities.
<i>PAYG</i>	Pay as you go
<i>Post-CGT</i>	Assets acquired after 19 September 1985
<i>Pre-CGT</i>	Assets acquired before 20 September 1985
<i>Panel</i>	The Australia's Future Tax System Review Panel
<i>TAA 1953</i>	Taxation Administration Act 1953
<i>Treasury</i>	The Treasury, Australian Government

Legislative References:

In view of the general nature of this report and to improve readability, references to relevant sections of the tax legislation have generally not been incorporated into the text.