

Level 2  
95 Pitt Street Sydney, NSW 2000  
**Telephone** 02 8223 0000  
**Facsimile** 02 8223 0077  
**Email** [tia@taxinstitute.com.au](mailto:tia@taxinstitute.com.au)  
**Website** [www.taxinstitute.com.au](http://www.taxinstitute.com.au)  
**ABN** 45 008 392 372



17 October 2008

AFTS Secretariat  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Email: [AFTSubmissions@treasury.gov.au](mailto:AFTSubmissions@treasury.gov.au)

Dear Sir

### **Australia's Future Tax System (AFTS)**

The Taxation Institute of Australia ('Taxation Institute') is pleased to provide the attached submission in response to the Australia's Future Tax System Review Panel's ('AFTS Review Panel') invitation on 19 August 2008 for public submissions as part of the comprehensive review of Australia's tax and transfer system announced by the Government on 13 May 2008.

The Taxation Institute strongly supports the AFTS Review, which encompasses Australian Government and State taxes, except the GST, and interactions with the transfer system and commends the Government for soliciting broad community feedback as part of this Review.

However, we are disappointed with two significant limitations contained within the Review's Terms of Reference that may affect the success of the outcomes, being:

- the exclusion of GST from the Review; and
- requiring any reforms to be consistent with the Government's tax to GDP commitments, which proved a major limitation in the review of business taxation commenced in 1998.

Although we will be discussing our submission with the AFTS Review Panel at our meeting on 23 October 2008 in Melbourne, the Taxation Institute is also able to make our representatives available for further discussions on tax policy review priorities during the course of this Review.

If you require any further information or assistance in respect of our submission, please contact the writer on 03 9286 6135 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours faithfully



Sue Williamson  
President



# **Australia's Future Tax System**

**Submission by the Taxation Institute of Australia**

**October 2008**

## TABLE OF CONTENTS

<b>1.</b>	<b>INTRODUCTION .....</b>	<b>2</b>
1.1	About the Taxation Institute of Australia .....	2
1.2	Structure and scope of our submission .....	2
1.3	Broad community feedback.....	3
<b>2.</b>	<b>CHALLENGES TO AUSTRALIA'S TAX-TRANSFER SYSTEM .....</b>	<b>4</b>
2.1	Introduction .....	4
2.2	Key challenges to the tax-transfer system.....	4
2.2.1	Large amounts of complexity.....	4
2.2.2	The 'Great Tax/Welfare Churn'.....	5
2.2.3	Productivity and competitiveness .....	6
2.2.4	Taxation of savings.....	6
2.2.5	Minimising the distortionary effects of the tax-transfer system.....	6
<b>3.</b>	<b>OPTIONS FOR ADDRESSING SYSTEM CHALLENGES.....</b>	<b>7</b>
3.1	Introduction .....	7
3.2	Defining the scope of Australia's taxing power .....	7
3.2.1	Introduction.....	7
3.2.2	Problems with the current system.....	7
3.2.3	Options for addressing system challenges .....	8
3.3	Company Taxation .....	8
3.3.1	Introduction.....	8
3.3.2	Problems with the current system.....	8
3.3.3	Options for addressing system challenges .....	9
3.4	Personal taxation .....	9
3.4.1	Introduction.....	9
3.4.2	Problems with the current system.....	9
3.4.3	Options for addressing system challenges .....	10
3.5	Taxation of non-cash benefits .....	11
3.5.1	Introduction.....	11
3.5.2	Problems with the current system.....	11
3.5.3	Options for addressing system challenges .....	11
3.6	State and Territory Taxation.....	12
3.6.1	Introduction.....	12
3.6.2	Problems with current system.....	12
3.6.3	Options for addressing system challenges .....	12

## **1. INTRODUCTION**

### **1.1 About the Taxation Institute of Australia**

The Taxation Institute of Australia ('Taxation Institute') is a national body of over 11,000 members, with a focus solely on taxation. Our members include tax agents, accountants, lawyers and members of the judiciary with an interest in taxation, in all its various forms, as well as officers of the Australian Taxation Office ('ATO'), Treasury and State Revenue Offices.

From its inception in 1943, the Taxation Institute has been a leading advocate and consultative body on the development and implementation of taxation policy and the administration of the tax laws. In particular, our Constitution provides that one of the Institute's roles is to contribute to the debate on tax-related issues in the community by advancing public knowledge and understanding of tax, the practices of public authorities administering tax laws and the attitude of Governments to tax. As part of this role, the Institute has made numerous major submissions on tax reform, particularly over the last decade.

In its advocacy and consultation, the Institute has worked closely in consultation with the Parliament of Australia (through Ministers and Parliamentary Committees), the Treasury and the ATO (as well their international counterparts), regulatory review agencies (including the Board of Taxation, Inspector General of Taxation, the Australian National Audit Office and the Tax Agents' Boards) and State and Territory Revenue authorities. We also have strong and constructive relationships with other tax professional, industry representative, and academic and research bodies, both in Australia and overseas.

Our submission draws on this considerable experience.

### **1.2 Structure and scope of our submission**

The Taxation Institute commends the Government for initiating its comprehensive review of Australia's tax and transfer system, *Australia's Future Tax System Review* ('AFTS Review'), announced on 13 May 2008 and accompanied subsequently by the release of Treasury's report *Architecture of Australia's tax and transfer system* ('Architecture Report') on 6 August 2008.

The Taxation Institute strongly supports the AFTS Review, which encompasses Australian Government and State taxes, except the GST, and interactions with the transfer system.

However, we are disappointed that GST is not included within the AFTS Review. In light of the Board of Taxation's current limited *Review of the Legal Framework for the Administration of GST*, which has already identified some 80 pages of issues with GST, the Taxation Institute also calls on the Government to introduce a comprehensive review of the GST. It is essential that the Government opens up the GST system to a full review to ensure its complexity is streamlined and the costs of GST compliance reduced.

Our following submission is in response to the AFTS Review Panel's invitation on 19 August 2008 for public submissions. It is our understanding that the AFTS Review Panel is soliciting broad community feedback at this stage preparatory to the release of a consultation paper by the end of 2008, which will be subject to further consultation in 2009, including a call for additional submissions.

Mindful that the AFTS Review Panel is gathering data and intelligence at this stage in the preparation of a consultation paper that will form the basis for further review processes, the focus of our submission is to identify a range of top level tax and transfer design policy issues that the

Panel might wish to take into account in framing its consultation paper. In doing so, our submission addresses the Terms of Reference for this Review by:

- identifying key challenges to Australia's tax-transfer system; and
- looking at possible options for addressing tax-transfer system challenges.

### **1.3 Broad community feedback**

Consistent with the AFTS Panel's current focus on gathering broad community feedback, to ensure the broadest possible base for Member feedback in preparing this submission we:

- surveyed our members across Australia (via an online questionnaire to gather Member views on the key reform issues and potential options for addressing them); and
- held face-to-face Roundtable reform discussion groups in Brisbane, Sydney, Melbourne, Adelaide and Perth.

This feedback has been considered in the preparation of our submission.

## **2. CHALLENGES TO AUSTRALIA'S TAX-TRANSFER SYSTEM**

### **2.1 Introduction**

Tax reform is a formidable challenge – it is a complex task as attested to by the aftermath of the calls and recalls every ten years or so for Australia wide tax reform.

The Taxation Institute believes that the Terms of Reference for the AFTS Review provide an important opportunity to break the past cycles of tax reform in Australia by recognising at the outset that tax reform impacts on every sector of the economy and Australia's potential for growth, both domestically and internationally.

Mindful of this broad environmental approach to taxation reform taken by the AFTS Review, the Taxation Institute recognises that 'big picture' tax reforms are ultimately driven to a large degree by a range of specific reforms to the tax-transfer system. Therefore, the approach taken in our submission is first to identify the significant broad challenges facing Australia's tax-transfer system, followed by an exploration of a range of possible options for addressing these challenges.

Set out below are the key challenges to the tax-transfer system identified by the Taxation Institute.

### **2.2 Key challenges to the tax-transfer system**

#### **2.2.1 Large amounts of complexity**

There is little doubt that the complexity of the tax-transfer system is a big problem, as highlighted in Chapter 11 of Treasury's Architecture Report.

The absence of simplicity results in tax laws that are complex (uncertain) and poorly designed, which in turn:

- imposes high compliance costs on the community;
- imposes high administrative costs on the tax authorities;
- results in socially unproductive and costly tax litigation;
- is counterproductive to the economic development of the country, in particular by jeopardizing economic neutrality;
- acts against public involvement in policy development; and
- generates disrespect for the rule of law.

In the words of Yale University Professor Michael Graetz when speaking generally about the US Governments failure to address compliance costs:

. . . simplicity always seems to be the forgotten stepchild of income tax policy. Routinely lip service is offered to the idea that tax law ought to be as simple to comply with and administer as possible; then, after a nod and a wink, vaulting complexity overleaps itself<sup>1</sup>

In saying this, the Taxation Institute also recognises that there is no one particular policy cause for complexity – it arises from everything from poor policy design and implementation through drafting and administrative systems.

Therefore, there is no easy policy fix for complexity – it's a matter of incremental change that could include the following tax-transfer design features:

---

<sup>1</sup> Michael J Graetz 'Taxing international income: Inadequate principles, outdated concepts, and unsatisfactory' (2001) 54 *Tax Law Review* 261 cited in Michael J Graetz *Foundations of international income taxation* (2003), 36.

- *Taxation is an integral part of any policy design:* Taxation must be an integral part of any policy design, not an after thought. The current Carbon Pollution Reduction Scheme process is an example where a design based around a carbon measurement system coupled with a policy of the creation of deep markets for permits has resulted in intractable tax complexity from the mismatch between reporting and the taxable entities and increased GST revenue despite the policy desire to not raise additional revenue.
- *Move away from global policy solutions:* There is a need to abandon the preoccupation with the continued adoption of global policy solutions. Examples of such poor policy designs leading to large compliance costs are Fringe Benefits Tax and the Foreign Investment Fund provisions where everything is a fringe benefit or a FIF unless there is an exemption.
- *Avoid over prescriptive tax laws:* There is a need to abandon the preoccupation with the “chase every cent” policy. The over- prescriptive nature of the laws and the “chase every cent” policy has in some cases resulted in a concession being so complex that few take it up, eg the former Simplified Tax System (STS) for small business.
- *Accurately identify and monitor compliance costs:* In order for the tax policy to be properly developed, it needs to be made with full knowledge about the costs of compliance of a measure. The *Treasury*, in consultation with the Australian Taxation Office should develop an enhanced ability to monitor and model the taxpayers’ compliance costs in the tax system. This should be supported by technological infrastructure that allows for a timely and robust monitoring capacity. Where the public good is deemed to be more important than the additional compliance costs imposed, Government needs to investigate the feasibility of compensation via a direct concession, via rebate (tax offset), a cash grant (based upon a percentage of turnover or the actual level of cost to the business) or a lower tax rate for business income of small businesses.
- *Compatibility of tax regime with international norms:* Australia has to deal in a global environment. Using terminology and tax concepts unique to Australia (eg in debit equity, in the GST terminology and in treaties) creates both treaty and other interface problems for both in bound and out bound investment.
- *Certainty in tax administration:* Ensuring that administrative systems that are introduced in order to implement tax change are consistent with the overall policy and are designed to minimise compliance and administrative costs. This also involves ensuring that legal clarification being undertaken in a manner that accords with the policy intentions of the legislation and delivers pragmatic and practical outcomes consistent with modern commercial and business practices.

### 2.2.2 The ‘Great Tax/Welfare Churn’

There is a need to reduce complexity and introduce better levels of equity into Australia’s personal taxation system by eliminating the current tax/welfare churn, which causes significant confusion about how tax should be collected at this level . For instance, current research indicates that:<sup>2</sup>

- the number of families receiving more tax offsets and transfer system benefits than they pay in income tax has increased by over 276,000 over the past four years to a record 4.113 million (42.2% of 9.754 million families); and

---

<sup>2</sup> According to research carried out by *The Weekend Australia* (also involving the Melbourne Institute of Applied Economic and Social Research) and reported in the article “Four in 10 families pay no tax” in *The Weekend Australian*, September 20-21, 2008, p1

- whilst 996,000 people have moved down a tax bracket from 30% to 15%, there is a new and significant problem for 134,000 taxpayers being pushed up a bracket from 30% to 40%. The large majority of these taxpayers have crossed the \$80,000 personal tax threshold, often in households with partners earning income from part-time jobs.

One of the challenges for the Australia's tax-transfer system is that there are people currently in the tax system who, from an administrative point of view, should not be there. There is a need to find ways to reduce compliance costs that also allow for the equitable taxing of these taxpayers.

### 2.2.3 Productivity and competitiveness

One of the major challenges for the AFTS Review is to ensure that there are sufficient and appropriate incentives to enhance Australia's productivity and international competitiveness. Central to ensuring these incentives are in place is a review of the current role and structure of company taxation in Australia.

There are clearly concerns at present about the international competitiveness of our current rate of corporate tax and tensions around how we tax business entities (for instance whether to apply substance over form under regimes such as the Taxation of Financial Arrangements (TOFA) and the debt/equity rules). However, we are not advocating that this review should necessarily be about pursuing for the lowest rate of company tax or adopting all the most attractive features of other countries' tax systems as a way to make Australia internationally competitive. It is about having an equitable comparative international tax system that people can understand and comply with cost efficiently.

### 2.2.4 Taxation of savings

The taxation of savings under Australia's current tax regime is distorted because of different tax treatments for different forms of saving. For instance, currently the tax regime effectively encourages the acquisition of capital assets (shares/land) and investment in superannuation over saving through interest bearing accounts.

Whilst the Taxation Institute is not advocating that the tax treatment of forms of saving other than interest bearing savings accounts should be changed, we believe there is a need to broaden the tax effective options for saving by improving the taxation of interest bearing savings accounts. This issue has now assumed more significance in the current troubled financial environment.

### 2.2.5 Minimising the distortionary effects of the tax-transfer system

The current tax/welfare churn and the taxation of savings are illustrative of the general need to ensure that the tax-transfer system minimises any distortionary effects. Our submission below examines options for dealing with this type of problem in these and other areas, such as the taxation of non-cash benefits.

### **3. OPTIONS FOR ADDRESSING SYSTEM CHALLENGES**

#### **3.1 Introduction**

In looking at options for addressing the above system challenges, there are three key policy issues to be addressed:

- who should be taxed?
- what should be taxed?
- how should tax be levied?

The Taxation Institute's submission effectively addresses these questions through the following five areas:

- defining the scope of Australia's taxing power;
- company taxation;
- personal taxation;
- taxation of non-cash benefits; and
- State and Territory taxation.

When considering these questions in the context of the above areas, each of the proposed questions may not carry equal weight or be of any particular issue. Our submission, therefore, only addresses what we believe to be the critical question or questions for consideration in each of these areas.

#### **3.2 Defining the scope of Australia's taxing power**

##### **3.2.1 Introduction**

While in theory public international law does not impose any limitations on a government's power to tax, it is widely accepted that a government's power is effectively limited to those taxpayers or those transactions that have a "sufficient connection" to the jurisdiction. The rules adopted in Australia to determine that connection (ie residency rules (applicable to individuals, companies and trusts) and the determination of the source of income) do not meet the tax policy objectives of equity, efficiency, and simplicity (particularly in respect of simplicity and the prevention of avoidance).

##### **3.2.2 Problems with the current system**

The law of residency and source is archaic. The statutory residency rules were introduced in 1930, while some of the statutory source rules have their genesis in the ITAA 1936, for others it is found in the 1915 Act and others in the 1890s' State and New Zealand income tax acts. Similarly the common law principles in respect of residency and source were established in the United Kingdom in the late 1890's. Thus, there has also been a lack of coherent tax policy development in respect of defining these jurisdictional taxing boundaries.

As a result the law does not effectively operate in the 21st century world where trade in services outstrips trade in goods and the communications revolution has removed the need for traditional physical linkages to jurisdiction. Given that profit is merely the difference between income and expenditure, finding its existence in a physical space (ie applying fictional physical source) is conceptually difficult and artificial. Therefore, it is not surprising that geographically based rules of attachment, developed in the late 19th and early 20th century struggle to deliver law that is equitable, efficient, simple and prevents tax avoidance.

The major weakness in most of the residency and source tests is the “individual fact and circumstances” element, which in certain situations:

- results in horizontal inequity;
- gives rise to the lack of simplicity; and
- leaves the rules open to manipulation.

Second, another cause of the complexity is the tendency to attempt to limit the application of particular corporate tax policy rules (for example, those rules applying in respect of deemed companies and those that operate for specific tax policy purposes) by modifying the company residency definitions in s 6(1) of the ITAA 1936.

The result is a myriad of definitions with many of the failings identified above. In designing the limitations in terms of current jurisdictional constraints, the policy makers have imported the weakness of the company residency definitions as well as imbedding common law concepts (such as central management and control). A similar process has occurred in respect of specialised trust residency definitions.

### 3.2.3 Options for addressing system challenges

Although the law can be modified, within the existing jurisdictional claim, to better meet simplicity, equity and efficiency, these changes would only be minor changes. Although they result in rules that better meet the evaluative criteria, the improvement is not dramatic.

Therefore, it is preferable to undertake a fundamental evaluation of Australia's taxation jurisdictional claim, than to adopt piecemeal solutions that merely fiddle at the edges. To ensure the success of such a fundamental evaluation of Australia's taxation jurisdictional claims, it is necessary first to clearly articulate what is the scope of that claim, before comparing it with the existing claim. It is only with this policy articulation that simple, equitable and efficient residency and source rules can be designed. In formulating this reform policy, consideration must be given to determine who or what should be a resident and which income of non-residents we wish to tax. It is only with this articulation that the absence of taxation can be viewed as an intended result rather than the result of avoidance.

Given globalisation, the changes in the world trade and technology revolution, the case for reform has never been stronger. Ultimately, the solution lies with a new, clear articulation of Australia's jurisdictional claim based upon robust tax policy objectives. In doing so it is important to determine what is the appropriate balance between source or residency for Australia's tax system?

## 3.3 Company Taxation

### 3.3.1 Introduction

Given that companies are in receipt of various forms income/receipts that provide economic benefit, in principle these receipts should be taxed provided the mechanism for taxation satisfies the criteria of efficiency, equity and simplicity.

### 3.3.2 Problems with the current system

Australia currently has a relatively high dependence on company income as part of its revenue base. However, the current complexity of the corporate tax regime has generated large levels of uncertainty in business transactions, with detrimental effects on both the ability of Australian companies to operate efficiently, profitably and cost effectively and on foreign investors seeking to invest in Australia. In particular, the current tax laws work against international competitiveness

and achieving the appropriate level of foreign investment. Given the complexity, lack of certainty and the perceived arbitrariness of the outcomes of the corporate tax laws, it is not uncommon to find potential foreign investors seeking to invest in other jurisdictions where tax laws are less arbitrary and carry less compliance costs.

### 3.3.3 Options for addressing system challenges

There are three broad options for addressing corporate taxation challenges:

- simplify the taxation of companies by exploring the possibility of a flow through taxing system for companies that is broadly consistent with the taxation of partnerships and trusts, with tax levied at the appropriate level of earning (e.g., at shareholder level) either directly or via withholding taxes. However, in exploring a flow through taxing model for companies, the Taxation Institute recognises that one major impediment is the current treatment of foreign residents where the focus has been on reducing withholding taxes through both domestic law and double tax treaty changes. Therefore, the adoption of this change would require the reintroduction of various withholding taxes;
- if companies remain as taxable entities, consider whether or not to maintain the current imputation system. Whilst we recognise that international developments show a move away from such systems, the Taxation Institute believes there needs to be good cause to make any changes to the dividend imputation system – it is supported strongly by Australian investors, aids in reducing corporate tax minimisation, achieves equity by eliminating double taxation and is an essential component of the design of our current system for taxing superannuation funds;
- if dividend imputation is maintained, there are a number of other key options that need to be explored:
  - review the current headline rate of Australian company tax in an international context to maintain our international competitiveness as a destination for foreign investment; and
  - review the current appropriateness of the corporate tax base to ensure that there are not inherent inefficiencies and distortions that drive inappropriate corporate practices (e.g., ensure current capital allowances reflect the value experienced in the market place, review the treatment of goodwill, assess the appropriateness of current capital management rules, review black hole expenditure, and consider providing for loss carry-backs, currently a major point of departure with a number of Australia's key trading partners).

## 3.4 Personal taxation

### 3.4.1 Introduction

Given that individuals are in receipt of various forms of both cash and non-cash remuneration that provide economic benefit, in principle individuals should be taxed provided the mechanism for taxation satisfies the criteria of efficiency, equity and simplicity.

### 3.4.2 Problems with the current system

There are numerous distortions in the current taxation treatment of individuals. In particular, there are people currently in the tax system who, from an administrative point of view, should not be there (42.2% of families) and there is a need to find ways to reduce compliance costs that also allow for the equitable taxing of individuals. Personal taxation distortions arise principally in respect of how income is recognized and in respect of allowable deductions.

The Australian tax system has been based on the individual as the taxing unit rather than the family and the taxation of the individual depends upon the categorization of income into "income from personal service" and "income from business". This historic classification process is arbitrary and complex leading to distortions such as personal tax minimisation arrangements including:

- the proliferation of "independent contractors" which continue to work at the principal contractor's previous employer, with the perceived potential to split income with spouses;
- the continued use of "husband-and-wife partnerships" by tradesman and farmers, where almost all (if not all) of the income is earned through the efforts of only one of the partners;
- the use of family trusts and service entities, with the potential to distribute business and investment income to lower-taxed beneficiaries and companies; and
- the use of family companies solely to earn investment and business income which is taxed only at 30%, rather than at the shareholders' high marginal tax rates.

In order to counter these specific legislation in respect of personal service business have been introduced (via Part 2-42 of the ITAA 1997) which has created both complexity and additional compliance costs.

However, in respect of many tax offsets and social security (transfer system) purposes family income is used. As a result families paying different amounts of tax where there is one principal earner versus dual income may in fact receive similar tax transfer benefits.

These distortions are continued in the context of deductions, in particular with the operation of ss 8-1 and 8-2 ITAA 1997 being a major source of dispute between the ATO and taxpayers. For instance, an "employee" taxpayer will be denied expenses associated in gaining piece meal work as they are capital (eg management fees paid by footballers, computer consultants, nurses, etc). Similar expenses associated with employment are denied either because they are deemed to occur prior to the income earning process (travel to work and child care expenses) or as they are private expenses (home office). This is also arbitrary as "business" taxpayers will often be able to claim many of these expenses.

### 3.4.3 Options for addressing system challenges

There are at least four broad options for addressing personal taxation challenges:

- recognise a "family" taxable entity basis (for instance all individual taxpayers should be able to lodge joint income tax returns overcoming the current mis-match between the measurement of family income for taxable and social security (transfer system) purposes);
- review the place of the individual within the tax-transfer system and remove complexity through a combination of transferring responsibility for tax collection to others (thereby effectively removing people/returns from the system as in New Zealand, the UK, Spain and Japan), simplifying the law and administration (for instance, through reviewing the deductibility of work related expenses, reviewing personal tax rates and looking at withholding tax at source on interest and dividends) and masking complexity through technology (for instance, through pre-filling of returns);
- replace the current capital/revenue distinction (e.g., as retained in s 8-2 of ITAA 1997 Act) with a system which effectively allows, as a general deduction, losses or outgoings incurred for the purpose of producing assessable income or, in carrying on a business for that purpose, but which provides for a number of specific exclusions unencumbered by phrases such as 'capital' or 'of a capital nature'; and
- provide incentives for taxpayers to save (for instance through targeted exemptions from tax and/or reduced tax on classes of income, such as capital gains and savings)

### 3.5 Taxation of non-cash benefits

#### 3.5.1 Introduction

Given that remuneration in a non-cash form provides economic benefit, in principle it should be taxed provided the mechanism for taxation satisfies the criteria of efficiency, equity and simplicity.

Currently, non-cash benefits supplied in association with employment are taxed at the employer level (via the *Fringe Benefits Tax Assessment Act 1986 (Cth)*) (FBT system) while third party non-cash benefits and non-cash benefits provided under independent service arrangements are taxable to the recipient under section 6-10 either by the use of sections 21, 21A and 26(e) of the *Income Tax Assessment Act 1936 (Cth)*.

#### 3.5.2 Problems with the current system

The fringe benefit rules are complex, uncertain, distortionary, and impose high compliance costs. Some of the difficulties are as follows:

- The taxation of non-cash “. . . benefits through the employer (rather than the employee) at the top marginal rate is seen as complex, administratively burdensome” (A Platform for Consultation (1998) Chapter 38). Much of the complexity arises from the FBT rules being drafted to capture “every cent” of non-cash benefit no matter how minor and the existence of two types of benefits (reportable and non-reportable);
- The FBT system “discriminating against employees on less than the top marginal rate” (A Platform for Consultation (1998) Chapter 38);
- The current system is inefficient creating the reduction of income tax through concessionary valuation rules;
- Entrenches a wage subsidy from the Commonwealth to charitable and not-for profit employees (by the use of the net reportable fringe benefit in income definitions for Family Assistance);
- Entrenches a revenue transfer to the States and Territories allowing them to reduce wages costs through splitting salary sacrifice benefits with employees (including the use of expense payment benefits for non-deductible entertainment); and
- There appears to be little compliance with the taxation of non-employee non-cash benefits.

Thus, the regime for taxing non-cash benefits is inequitable, is unduly complex and administratively costly to comply with.

#### 3.5.3 Options for addressing system challenges

There are two broad options available:

- First, although it is politically easier to tax the employer/provider, rather than the employee,<sup>3</sup> one reform option is to consider standardising the taxation on non-cash benefits by the taxing them in the hands of the persons providing the service that gave rise to the non-cash benefit. This will reduce some of the compliance costs for employers.

---

<sup>3</sup> Historically, every time Governments have attempted to strengthen the taxation of non cash benefits they have had to back down, e.g. (I) the former s 26AB introduced by Whitlam Government in the early 1970's to assess motor vehicle benefits was withdrawn as it effected many workers and union officials; and (II) the Fraser Government's s 26AAAA, which assessed taxpayers in respect of housing benefits, lead to mining strikes in late 1970's and another Government back down.

- The second option is to consider simplifying the taxation of non-cash benefits by just targeting the major benefits widely offered as packaged benefits

### **3.6 State and Territory Taxation**

#### 3.6.1 Introduction

The Taxation Institute is concerned that the current Federal-State tax divide unnecessarily impacts adversely on many taxpayers, particularly those in businesses operating across State borders that are affected by too many taxes imposed at various levels of government. Key concerns here are complexity and the cost of complying with various levels of taxes.

#### 3.6.2 Problems with current system

Whilst there is a need to continue the harmonisation of States taxes (such as stamp duty and payroll tax) and to remove inefficient and nuisance State taxes, one of the key causes of complexity and upward pressure on costs of compliance is how State taxes are administered and collected.

#### 3.6.3 Options for addressing system challenges

Options to address the current model for the Federal – State tax divide include:

- a standard administrative and legal structure for State taxes administrated by the Commonwealth (for instance, the Commonwealth having administrative responsibility for the common taxes levied by all States and Territories such as payroll tax);
- replace State and Territory taxes with a uniform income tax surcharge;
- or if State and Territory taxes remain, grant States and Territories access to additional Federal funding through further tax sharing (for instance, through allocating part of company tax); and link this funding to enforceable commitments to eliminate inefficient State taxes and improving service delivery.