



Taxation Institute of Australia

2011 - 12 Federal Budget Submission

11 February 2011

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Ms Jan Harris
General Manager
Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Email: prebudgetsubs@treasury.gov.au

Dear Ms Harris

2011-12 Pre-Budget Submission

The Taxation Institute of Australia (**Taxation Institute**) is pleased to present our priorities for the 2011-12 Federal Budget.

The Taxation Institute has summarised below the issues which we consider should be a priority for the Government to consider. These issues are discussed in more detail in the appendix.

Priorities for the 2011-12 Budget

1. Tax reform

- a. Clarify the taxation of trusts
- b. Clarify the policy position regarding encouraging foreign investment
- c. GST – exploring options for reform
- d. Working within the COAG framework to assist State governments to reduce the compliance burden imposed by state taxes
- e. Improve the Excess Superannuation Contributions Tax

2. Regulatory reform

- a. Bringing financial planners within the Tax Agent Services Regime
- b. Establishing the Tax System Advisory Board and expanding the powers of the Board of Taxation

An overview of the underlying principles on which our selection of priorities is based is as follows.

The Taxation Institute has repeatedly called for robust debate on, and sustained commitment to, tax reform for the benefit of all Australians.

The benefits of a tax system that:

- encourages savings and investment;
- makes Australia an attractive destination for foreign investment;
- is simple to understand;
- equitable in application; and
- certain in effect;

will flow to all Australians in the form of a stronger economy.

The Henry Review generated significant debate on tax reform. We strongly urge the Government to facilitate the distillation of ideas in this debate during the Tax Forum to be held later this year. It is imperative that the Government harness this momentum and seize the opportunity to set a vision for tax reform that will deliver the tax system that Australia needs.

We recognise that some aspects of this vision may be difficult to implement in the current economic and political climate. Nevertheless, it is now, in the wake of the Global Financial Crisis that Australia, led by its Government, must stop to consider what reforms are necessary to further strengthen our economy.

Taxation revenue collections in Australia are currently greatly dependent on taxes that have an adverse effect on investment and workforce participation (such as income tax). We urge the Government to consider a shift away from such tax towards the simpler and more stable consumption taxes which have a relatively minor effect on domestic and foreign investment. Notably, many countries have already instigated tax reform of this nature.

By embarking on a process of tax reform of this nature, the Government will, in the future, be able to rely on a more robust revenue stream in tough economic circumstances to either fund existing expenditure or economic stimulus.

Consideration of these matters will also require leadership from the Government on the issue of National and State Government relations, including on the issue of State taxes and revenues. We urge the Federal Government to take the reins on this issue and bring the States on board with a unified vision for tax reform in Australia which includes the repeal of inefficient State taxes.

State taxes are increasingly irregular, inconsistent, inefficient and a brake on investment and growth. The Federal Government must work with the States to ensure state revenues are protected as inefficient state taxes (including stamp duty, payroll tax and land tax) are abolished.

Finally, the Taxation Institute would welcome an invitation to participate in any Budget lock-up on 10 May 2011, prior to the Treasurer's Budget speech to the Parliament and the public release of the Budget papers. The Taxation Institute has participated in the 2005 to 2010 lock-ups. Given that our 13,000 tax practitioner members throughout Australia (including small rural and suburban accountants, senior members of the bar specialising in tax and tax practitioners servicing large corporations) rely upon our report of key budget measures affecting their clients, it is crucial that we are able to report this in a timely manner.

Should you have any queries with respect to any of the matters raised above, please do not hesitate to contact me on (03) 9288 6677 or the Taxation Institute's Senior Tax Counsel, Robert Jeremenko on (02) 8223 0011.

Yours faithfully



Peter Murray
President

APPENDIX

Taxation Institute of Australia Pre-Budget Submission 2011-12

1 Tax reform

1.a Clarify the taxation of trusts

The Taxation Institute has long called for urgent reform of the rules governing the taxation of trusts in order to provide certainty to thousands of businesses that operate through trusts (including SMEs) across Australia. The need for clarification of these rules has been highlighted by a number of events in the past year, including the High Court's decision in the case of *Bamford*, the uncertainty surrounding the treatment of unpaid present entitlements in the context of Division 7A and the ATO's withdrawal of its ruling on averaging income for primary producers.

Reform of these rules is essential to provide the thousands of taxpayers that use trusts with certainty in relation to their income tax obligations, reduce compliance costs and prevent outcomes under current laws that are inconsistent with the policy intent of the legislation.

In addition to our membership of tax professionals, the Henry Tax Review and the Treasury "Red Book" advice to the Government also recommended that the trust tax laws be rewritten.

We welcomed the Government's commitment in December 2010 to review and resolve the major uncertainties caused by the *Bamford* decision, and legislate the ATO's pre-*Bamford* position in relation to averaging income for primary production trusts. The Taxation Institute urges the Government to use this opportunity to undertake a comprehensive review of the taxation of trusts and rewrite Division 6 to resolve all of the issues and uncertainties that these laws have given rise to, whether or not these issues were in question in *Bamford*.

1.b Clarify the policy position regarding encouraging foreign investment

The TPG Myer case, and the subsequent determinations issued by the ATO in relation to the capital/revenue characterisation of investments made by private equity firms and treaty shopping have created great uncertainty for foreign investors and in particular foreign private equity funds. The ATO took more than 11 months to finalise these determinations (after issuing each in draft form in December 2009) and has recently issued two more draft determinations on the source of profits made by private equity funds and business profits of a foreign limited liability partnership.

The Taxation Institute considers that foreign and domestic private equity funds have an important role to play in invigorating and promoting an efficient economy. While the total percentage of foreign investment into Australia contributed by private equity firms remains small compared to more traditional investment models, growth in the private equity sector has been significant over the past decade.

It is also our view that the position taken in these determinations is a questionable interpretation of the existing laws and at odds with the Government's stated position of encouraging foreign investment in Australia (as per the amendments to the CGT rules exempting foreign investors from tax on gains on capital assets other than taxable Australian property).

The approach taken by the Australian Government and the ATO on the taxation of gains made by private equity funds will in part determine the light in which Australia is viewed by foreign investors as a potential destination for investment.

The Taxation Institute recommends that the Government clarify its policy position on this issue, in line with its previously stated policy of attracting foreign investment. Further, there should be clarification specifically in relation to the application of the policy to private equity funds.

1.c GST – exploring options for reform

The GST generates approximately a third of the Government's total revenue and represents the Government's most rapidly increasing revenue source. The significant role that the GST will play in tax policy and revenue collection over the next decade cannot be underestimated. As a result, it is imperative that the Government consider the scope for reform to our existing GST laws as a part of a robust debate on tax reform.

Despite the Henry Review being prevented from exploring options for GST reform, the Review Panel noted that “[a] simple cash flow tax designed to tax private consumption as broadly as possible could be an important element of Australia's tax system into the 21st century.”

Since the introduction of the GST more than 10 years ago, piecemeal reforms have been made to these laws mostly to clarify the existing policy position. However, the GST has not enjoyed the type of whole scale review to which the rest of the tax system has been subjected by the Henry Review Panel. In order to create a certain, simple and equitable environment for business and individuals, it is essential that options for reform of the GST be considered fully, from a taxation and economic viewpoint.

The Taxation Institute urges the Government to consider adopting a policy of shifting Australia's dependence on income tax for the lion's share of revenue collections towards more simple and stable consumption taxes such as the GST over the coming decade. Such a shift will ease the presently adverse effect of Australia's current tax rates on individuals and corporate entities, will create a simpler tax system to implement and regulate and will provide the Government with more stable revenue collections.

The Government should consider the impact of such reforms on taxpayers in lower income tax brackets to ensure that such taxpayers do not suffer adverse tax consequences.

1.d Working within the COAG framework to assist State governments to reduce the compliance burden imposed by state taxes

The Henry Review Panel noted that 90% of Australia's tax revenue is generated by only 10 taxes. The States (between them) levy 25 different taxes, many of which raise miniscule revenues but increase compliance costs. Even where the same type of tax is levied across the States (such as payroll tax or stamp duty), the applicable thresholds, rates and exemptions differ across the States, significantly increasing compliance costs for individuals or businesses that invest or operate in more than one State. Significant OSR resources are drained in resolving issues of implementation and compliance with respect to this inefficient and often archaic collection of taxes.

The Taxation Institute urges the Government to seize the opportunity provided by the Tax Summit to set a national vision for tax reform that includes the repeal of inefficient State Taxes. In order to achieve this goal, we encourage the Government to set a new tone for inter-governmental relations by working with State Governments within the COAG framework to assist States in replacing lost revenue as appropriate.

Increased co-operation between the Federal and State Governments on this issue will result in significant benefits for Australians, including making Australia a simpler place to do business (thereby encouraging investment), decreasing compliance costs, increasing efficiency within State Governments and allowing funding to be directed to States according to each State's needs (rather than the current relatively arbitrary allocation of revenues from State Taxes).

1.e Excess Super Contributions Tax

Superannuation laws, since their introduction, have been amended time and time again by the Government to the point that many Australians are now confused about their rights and obligations with respect to the superannuation system. The changes in contribution caps have resulted in many

Australians inadvertently breaching the statutory contribution caps and attracting a liability for excess super contributions tax of up to 93% of the excess contributions.

In the 2009 income tax year, approximately 30,000 taxpayers were identified as having potentially breached the contribution caps.

Many of these taxpayers will have breached the cap due to factors largely outside their control such as where the taxpayer has two or more unrelated employers meeting their respective superannuation guarantee responsibilities, pre-existing salary sacrifice arrangements and/or fixed contribution arrangements. Others will have made genuine mistakes, perhaps at a time of personal stress or grief, and may have been unaware of the significantly onerous consequences of their actions.

Compounding the problem, the Commissioner of Taxation has construed his discretion to disregard or reallocate contributions very narrowly, leaving most taxpayers who have inadvertently breached the contributions cap without remedy. Approximately 80% of applications lodged by taxpayers for an exercise of the Commissioner's discretion are denied.

Moreover, unlike many other taxes, the rate of excess contributions tax is not merely intended to compensate for revenue lost as a result of a breach of the laws, but operates as a punitive measure i.e. excess contributions are taxed at the top marginal tax rate irrespective of the taxpayer's actual marginal tax rate.

Such an outcome is contrary to the principles on which our taxation system is based, and may discourage investment in superannuation funds (for fear of breaching the cap) by the very taxpayers whom the Government intended to encourage contributing to superannuation due to their impending financial needs during retirement.

The Taxation Institute urges the Government to amend the superannuation laws such that excessive contributions can be returned to the contributor. We also suggest that employees be allowed to elect out of the super guarantee system in situations where excessive contributions would arise. Such measures should ensure that unintentional breaches of the caps could be rectified, whilst preserving the policy intent of the caps.

2 Regulatory reform

2.a Bringing financial planners within the Tax Agent Services Regime

The Tax Agent Services Regime (**TAS regime**) was introduced in 2009 to “ensure that tax agent services are provided to the public in accordance with appropriate professional and ethical standards” (Explanatory Memorandum to the *Tax Agent Services Bill 2009*). This regime was introduced to protect consumers of tax advice by providing assurances as to competence and reputation, and providing for safeguards and penalties for breach of the stipulated standards.

The TAS regime creates a national standard for regulation, which ensures that all tax advice provided in Australia may be reasonably relied on by consumers to claim entitlements under a taxation law.

In order to preserve the integrity of this policy intent, financial planners that provide tax advice in the course of providing financial advice must be subject to regulation by the Tax Practitioners Board and required to ensure that any tax advice provided is of the standard that Australians are entitled to expect from their advisers.

If tax advice provided by financial planners is not so regulated, consumers of such unregulated advice will not enjoy the protections or assurances that underpin the TAS regime, and as a result the very integrity of the regime will be compromised. The TAS regime was implemented exactly for the purposes of countering such sidestepping of regulation.

Most Australian taxpayers are eager and willing to satisfy their obligations under taxation laws and depend on tax advice from qualified professionals for this purpose. As a result, most taxpayers are exposed to the adverse outcomes that may result from inaccurate or incomplete tax advice.

It is essential that the Government assist taxpayers by requiring that all tax advice that may be reasonably relied on to fulfil these obligations is of an acceptable standard.

The Taxation Institute welcomed the Assistant Treasurer's announcement in November 2010 of Treasury's Options Paper and subsequent consultation on this issue. We urge the Government to protect consumer's rights and bring financial planners within the ambit of the TAS regime following this consultation.

2.b Establishing the Tax System Advisory Board and expanding the powers of the Board of Taxation

The Taxation Institute welcomes the Assistant Treasurer's announcement on 21 January 2011 in respect of consultation on the design of the Tax System Advisory Board (**TSAB**). While we are generally supportive of the Government's aims in setting up the TSAB, we urge the Government to ensure that it has sufficient resources and powers to fulfil its responsibilities and does not lead to overregulation.

The then Assistant Treasurer (Nick Sherry) also announced on 5 August 2010 during the election campaign that "[a] re-elected Gillard Labor Government will boost and reshape the role of the Board of Taxation by empowering it, in consultation with the government, to initiate its own reviews to examine how current tax policies and laws are operating. We will also adjust its membership as necessary to ensure it is correctly balanced and fully representative."

The Taxation Institute urges the Government to implement these promised reforms. The Board of Taxation plays a significant role in providing an expert perspective that assists in the design and implementation of tax laws. The expansion of the Board's powers in the promised manner will be a significant improvement in the process by which changes to existing tax laws and the design of new tax laws is investigated and implemented.

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