



THE TAX INSTITUTE

The Tax Institute

2014-15 Federal Budget Submission

28 February 2014



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Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Attention: Mr Stephen Hally-Burton

via email: prebudgetsubs@treasury.gov.au

Dear Mr Hally-Burton

2014-15 Federal Budget Submission

The Tax Institute is pleased to respond to the invitation from the Treasurer, The Hon Joe Hockey MP, to submit our ideas and priorities for the 2014-15 Budget. We trust that this submission will assist in providing an insight into the opportunities to improve tax policy outcomes for all Australians.

The Tax Institute is Australia's leading professional association in tax, with more than 14,000 tax members. Further details about The Tax Institute are included at Appendix A.

Context

The Tax Institute continues to advocate for the Government to provide a sustained commitment to tax reform for the benefit of all Australians. This requires a measured and structured approach to reform, that includes a timeline and a process for advancing priority issues.

Despite Australia's budgetary position, it is crucial that we do not delay the hard work on policy formulation that is required to improve our tax system. To ensure that the country is well positioned for the challenges of the decades ahead, Australia must do the preparatory work now to ensure the tax reform debate continues and that there is a plan for reform in the coming years as our budgetary position improves.

The benefits of tax reform will flow to all Australians in the form of a stronger economy.

Australia's tax and transfer system must strive to be efficient, equitable and simple. The system should encourage savings and investment as well as greater workforce participation. The revenues generated by the system should be sufficient to meet public and social needs, in turn supporting economic growth. In addition, it is important that the superannuation system provides Australians with access to a minimum standard of living in retirement.

The Tax Institute has formulated a set of Tax Policy Principles that serve to guide thinking about Australia's tax system and possible reforms; the principles are at Appendix B.

As recognised in *Australia's Future Tax System Review* (the Henry Review), tackling the economic, demographic and environmental challenges that face Australia over the medium to longer term require planning and commitment today. We welcome the Government's commitment to consulting on a Tax Reform White Paper in the second half of calendar year 2014.

In this context, below is a summary list of issues and recommendations that The Tax Institute considers should be a priority for the Government to consider in the 2014-15 Budget; this list is not in any particular order. These issues are discussed in further detail at Appendix C.

Priorities for the 2014-15 Budget

Building on the Henry Review platform and proceeding with Tax Reform White Paper

The Tax Institute supports ongoing analysis of potential reforms to Australia's tax system, which are consistent with the Henry Review platform. We welcome the announced Tax Reform White Paper consultation in the second half of calendar year 2014 and look forward to the Government setting a timetable for this consultation as soon as possible.

Child care affordability

There are many women who would participate in the workforce except for the unavailability of child care. In many cases these individuals would earn higher wages than the wages of the child care workers and be able to make contributions to their superannuation funds. Therefore, a tax concession to subsidise the cost of child care should provide a positive benefit to the Australian economy by generating tax revenue in the form of income tax on wages.

Two options for improving access to child care through the tax system would be to allow a tax deduction for child care costs and to use a refundable tax credit or cash grant.

State tax reform

The Tax Institute urges the Government to take a leadership position on State tax reform and bring the States on board with a unified vision for tax reform in Australia. This would include increasing Australia's reliance on consumption taxes (such as the GST) and abolishing inefficient and complicated State taxes (such as conveyance duties and insurance duties). The Government should consider the impact of such reforms on taxpayers in lower income tax brackets to ensure that such taxpayers do not suffer undue adverse consequences.

Company tax reform

The Tax Institute supports reducing the company tax rate in the medium term from its current 30% to the 25% recommended by the Henry Review. The Government's announced 1.5% reduction for the year ended 30 June 2016 is a step in the right direction, however The Tax Institute would encourage the Government to immediately proceed to a 2% reduction. Any such reduction should not be completely negated by a levy on some companies to support the Paid Parental Leave Scheme.

Multinational taxation

The Tax Institute welcomes the Government's commitment to addressing base erosion and profit shifting (BEPS) in conjunction with Australia's G20 partners through its endorsement of the OECD action plan on BEPS in July 2013. We support implementation of measures consistent with the OECD recommendations on BEPS, which are due to be released in September 2014, to ensure that multinational companies pay tax in the country where revenue is earned.

Tax transparency

The Tax Institute broadly supports efforts to increase transparency that allow tax authorities to properly understand taxpayer circumstances and apply tax laws correctly and in a timely fashion. These measures should be consistent with any OECD recommendations on international tax transparency. Further, the information obtained and disclosed publicly should be relevant and able to be reviewed and contextualised by the taxpayer concerned prior to disclosure. The impact of public disclosures on private companies should be carefully considered.

Small business

The Government must continue the significant work that remains to be undertaken in respect of simplifying existing tax laws to alleviate the compliance burden on small business. This includes exploring the possibility of creating a separate 'small business entity' structure; streamlining access to small business concessions; and simplifying carry-forward loss integrity measures.

Alcohol tax reform

The Tax Institute calls on the Government to further analyse and investigate the merits of reforming the current system of taxing alcohol. This would include evidence-based analysis, including consideration of transitional arrangements that might be required should a common volumetric tax be proposed. The Government may wish to consider the impact of a common volumetric tax on health outcomes as part of a review.

Trust tax reform

Reform of the rules governing the taxation of trusts as part of the Tax Reform White Paper process 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 Government's policy intent. We encourage the Government to engage the Board of Taxation on trust tax reform.

Financial advisers providing tax advice

In the interests of consumer protection and preserving the integrity of the Tax Agent Services Regime, we urge the Government to maintain the legislated start date of 1 July 2014 from which financial advisers will be brought into the Tax Agent Services Regime.

Superannuation

The Tax Institute encourages the Government to collaboratively construct a long-term, holistic plan for the superannuation system focussed on equity and sustainability. This includes addressing the low level and inflexibility of contributions caps, including via repeal of the '10% rule' and further improving the excess contributions tax arrangements.

Announced but unenacted tax measures

Whilst we welcome moves by the Government to clear the unenacted measures backlog and prioritise the remaining unenacted measures, it is imperative that the Government continues to monitor announced measures in future to ensure that a backlog does not develop again. The prioritised measures should be legislated as soon as possible.

Relevant Government agencies, including the Department of the Treasury and the Office of Parliamentary Counsel, should have sufficient resources dedicated to both implementing these measures and preventing any future backlog.

Deregulation

The Tax Institute supports the Government's deregulation initiative and the publishing of a regulation impact statement in respect of each tax reform. However deregulation should not be at the expense of sound reform in areas such as regulation of financial advisers providing tax advice.

Budget 'lock-up'

Finally, The Tax Institute would welcome another invitation to participate in the Treasury stakeholder 'lock-up' on Budget night, 13 May 2014. Given that our 14,000 tax 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 either me or Senior Tax Counsel, Robert Jeremenko, on (02) 8223 0011 or 0468 987 300.

Yours sincerely

A handwritten signature in black ink, appearing to read 'M. Flynn', followed by a long, horizontal, slightly wavy line.

Michael Flynn
President

APPENDIX A

About The Tax Institute

The Tax Institute is Australia's leading professional association in tax, with more than 14,000 tax members. The Tax Institute sets the benchmark for the most up-to-date tax professional development events and education programs in the country. This means that members of The Tax Institute are best placed to have the highest level of expertise in the field.

The growing membership base includes tax professionals from commerce and industry, academia, government and public practice throughout Australia.

The Tax Institute's reach now extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the numerous specialist, practical and accurate tax publications – all of which ensure that the latest information is available at their fingertips.

Established in 1943, the purpose of The Tax Institute was to provide education and information products and services to the tax profession as well as support improvements in the tax law and its administration. That core purpose remains.

Today we lead the tax profession with a strong and authoritative voice in supporting a fair and equitable tax system in Australia, whilst at the same time providing a full suite of education and information products that keep today's tax professional up-to-date and build the capacity of the next generation of tax professionals.

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APPENDIX B

Tax Policy Principles

- Tax laws exist primarily to generate revenue to aid the function of Government and the provision of Government services.
- Tax laws may also fulfil the function of either encouraging or discouraging certain activities, as defined by Government.

In fulfilling these goals, our tax system should:

1. Meet the Government's revenue needs.
2. Consider these revenue needs in a broader and longer-term context of current and future Government services, anticipated demographic changes, the specifics of our economy (such as heavy Australian reliance on foreign capital).

Efficiency

3. Minimise distortions wherever possible, unless intended. This means minimising special treatments, exemptions and cliffs in the tax system (especially in relation to substantive tax provisions) where possible.
4. Encourage or discourage only those behaviours that are intended to be affected.
5. Support growth, productivity (including workforce participation), investment and desired social outcomes (such as equity).
6. Tax entities (companies, trusts, partnerships) as conduits.
7. Tax individuals, superannuation funds and not-for-profits as ultimate taxpayers.
8. Seek to tax the substance of the transaction appropriately, but only via clearly defined laws rather than the inclusion of nebulous concepts in legislation.
9. Levy taxes on a uniform base where possible (for example, current taxes on the factors of production: land tax and payroll tax).
10. Levy taxes on the basis of a broad base, low rate principle.

Equity

11. Be horizontally equitable in relation to each type of final taxpayer. Integrity provisions may be necessary to safeguard equity and prevent specific taxpayers from taking advantage of current laws.

Simplicity

12. Be simple to understand and apply, unless the desired outcome can only be achieved via complexity and after taking the cost of that complexity into account.
13. Resolve integrity concerns commensurate with risk to revenue/risk to integrity.
14. Minimise compliance costs for both taxpayers and the ATO.
15. Rely on safe harbours and sound administration/interpretation rather than blunt legislative instruments where possible without jeopardising the rights of taxpayers or the rule of law.

Other

16. Be formulated with reference to the current structure of the system, including taxation (including state taxation), offsets, transfers and other Government payments.
17. Be formulated with reference to, and after proper consultation with, the relevant stakeholders, including taxpayers, the revenue authority, the Inspector-General of Taxation and other relevant agencies.
18. Cost measures in line with an objective standard, and also with reference to likely behavioural changes by individuals, investors, businesses etc.
19. Be altered prospectively only, unless retrospective application would not be adverse to taxpayers or retrospectivity is necessary to protect the integrity of the tax system.
20. Changes should be legislated as soon as possible after announcement, subject to the need for consultation. This is especially so if the measure applies from date of announcement or earlier.
21. Not be altered unless necessary. If necessary, should be altered in line with the principles set out above.

APPENDIX C

The Tax Institute 2014-15 Federal Budget Submission

Context

The Tax Institute continues to advocate for the Government to provide a sustained commitment to tax reform for the benefit of all Australians. This requires a measured and structured approach to reform, that includes a timeline and a process for advancing priority issues.

Despite Australia's budgetary position, it is crucial that we do not delay the hard work on policy formulation that is required to improve our tax system. To ensure that the country is well positioned for the challenges of the decades ahead, Australia must do the preparatory work now to ensure the tax reform debate continues and that there is a plan for reform in the coming years as our budgetary position improves.

The benefits of tax reform will flow to all Australians in the form of a stronger economy.

Australia's tax and transfer system must strive to be efficient, equitable and simple. The system should encourage savings and investment as well as greater workforce participation. The revenues generated by the system should be sufficient to meet public and social needs, in turn supporting economic growth. In addition, it is important that the superannuation system provides Australians with access to a minimum standard of living in retirement.

As recognised in *Australia's Future Tax System Review* (the Henry Review), tackling the economic, demographic and environmental challenges that face Australia over the medium to longer term require planning and commitment today. We welcome the Government's commitment to consulting on a Tax Reform White Paper in the second half of calendar year 2014.

Building on the Henry Review platform and proceeding with the Tax Reform White Paper

It is now more than five years since the commissioning of the Henry Review; as described by the then Government: 'the once in a generation ... root and branch review of Australia's tax system'.

The Henry Review looks forward over the next 40 years and foresees:

- a new world economic order based on ever-deepening international integration;
- the transformation of business, commerce and personal lives by technological advances;
- the ageing of the population, reducing some tax bases and raising the costs of health, aged care and dependency;
- strong growth and cultural diversification of our population, with high demands for economic infrastructure, education and social infrastructure spending;
- deepening stresses between human activities and wider ecosystems, globally and locally; and
- further stresses on housing affordability and pressure on urban amenity.

The Henry Review found that much of the existing architecture of our tax system ‘reflects sound policy frameworks and Australian social values and will still serve us well’. However, it set out to define a tax and transfer system that better anticipates and responds to these challenges over the coming years.

Taxation revenue collections in Australia are currently greatly dependent on taxes that have an adverse effect on investment and workforce participation. The Henry Review’s vision was to concentrate on four robust and efficient broad-based taxes: personal income; business income; economic rents from natural resources and land; and private consumption.

Other revenue taxes (mainly State taxes) should be abolished, with more reliance on taxes on rents and consumption, rather than business income.

The Tax Institute supports ongoing analysis of potential reforms to Australia’s tax system, which are consistent with the Henry Review platform as outlined above. We urge the Government to proceed with the promised Tax Reform White Paper and to set a timetable for this consultation as soon as possible.

Child care affordability

Australian families are increasingly balancing work and family responsibilities and there is a direct relationship between the price of child care and whether women return to the workforce.

Studies show that, in economic terms, the labour supply behaviour of women with young children responds negatively to child care price. This means that, as the price of child care increases, there is a corresponding decrease in the number of hours that women are in paid employment. This indicates that, for parents who need to use child care to work, child care is a cost of employment. Despite the longer term benefits of returning to work (including making superannuation contributions), in the short term, the costs of child care significantly reduce the value of doing so.

The Henry Review found that the current system of child care assistance recognises that parents and children in different circumstances will require different amounts of assistance. It concluded that the amount of child care assistance should be higher at low income levels and means tested as income increases, but that a base level of assistance should be provided across the income spectrum to facilitate participation.

Under the current tax law, a tax deduction is not available for a loss or outgoing of a private or domestic nature irrespective of whether that expenditure is necessary in order to earn income. As a result, child care costs are deemed private expenditure which is not deductible, although they are, in most cases, essential because of a taxpayer’s employment.

The Henry Review acknowledged that our current system is confusing, with high effective marginal tax rates adversely influencing taxpayer behaviour. Means-testing access to child care payments contributes to high effective marginal tax rates. It encourages lower income earners back into the work-force with the presumption that higher income earners will return to work irrespective of the concession.

Tax deductions for the costs of child care, if appropriately targeted, would encourage highly educated women who bear the primary responsibility for domestic duties to return to work. Tax deductions should only be available to reduce the tax on income from employment or self-conducted business income so that they are unequivocally tied to enhancing productivity. That is, there is no point giving a subsidy to reduce the tax on investment income. As such, we do not support subsidising the child care expenses of a parent who is still at home earning bank interest or share dividends.

The advantage of making child care costs tax deductible is that it relies on market forces (rather than Government intervention) to determine work force participation and to allow legitimate costs of work force participation to be appropriately deducted from income. Tax deductibility would assist in eliminating existing positive incentives for primary carers to stay out of the workforce, yielding a variety of benefits for individual families as well as the nation.

Tax-deductibility of child care costs therefore deserves careful consideration and study. We accept that any such scheme would need to be supplemented with means-tested access to the child care rebate, to ensure that women in lower marginal tax brackets who cannot benefit as greatly from deductibility of child care are also appropriately supported.

Some level of means-tested support may well be necessary as some low income families will require additional assistance. However, this assistance should be in addition to a wider consideration of deductibility of child care costs.

The main argument against making child care costs tax deductible is that it tends to favour higher wage earners. Viewed through the productivity lens this might be seen as an advantage, because it provides the greatest encouragement to the most productive workers. Nevertheless, many in the community would regard it as undesirable to make the tax system less progressive. A refundable tax credit or cash grant would avoid this outcome. Therefore, if the Government is not prepared to endorse tax deductibility it should consider making available a refundable tax credit or cash grant.

Adopting either tax deductibility or tax credits/cash grants would provide a direct benefit for the nation by increasing productivity and generating tax revenue for the government in the form of income tax on wages.

State tax reform

The Tax Institute urges the Australian Government to take a leadership position on State tax reform and bring the States on board with a unified vision for tax reform in Australia. State taxes are inefficient and irregular, providing an impediment to investment and growth. The Australian Government must work with the States to ensure their revenues are protected as inefficient State taxes are abolished.

The GST will generate approximately \$50 billion this year and represents an 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.

Since the introduction of the GST more than 13 years ago, piecemeal changes have been made to the law 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. 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 both a taxation and economic viewpoint.

The Tax Institute urges the Government to consider adopting a policy of shifting Australia's dependence on income tax for the bulk 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 undue adverse consequences.

Each State has significant revenue needs that stem from the multitude of State government responsibilities and programs that are integral to ensuring an appropriate delivery of services to residents. In our view, the quandary of balancing the autonomy of State revenue generation with the need for simplicity in Australia's tax system overall needs to be determined in the context of a core set of principles.

Each State government needs to work with the Australian Government within the Council of Australian Governments (COAG) framework to build a tax system that creates greater autonomy for States through increased revenue generation from Federal taxes.

However, it is also imperative that this COAG framework is robust, such that any agreement to abolish taxes is adhered to. This would require breaches of agreements to be dealt with in a serious manner, to prevent instances of States reneging on commitments.

Specifically, The Tax Institute submits that:

- Australia should increase its reliance on consumption taxes (such as the GST) and abolish inefficient and complicated State taxes (such as conveyance duties and insurance duties);
- Such an increase in revenue from the GST should be the result of an increase in the rate and/or a broadening of the base of the GST;
- Governments should consider the impact of such reforms on taxpayers in lower income tax brackets to ensure that such taxpayers do not suffer undue adverse consequences;

- The resulting increase in GST revenue collected should flow to the States through an automated mechanism; and
- In return for the increased GST revenue, each State must agree to an enforceable timetable to abolish inefficient taxes.

In this regard, we would broadly support a reduction in the overall number of State taxes levied in favour of each State Government deriving its income from a smaller number of efficient and broad based taxes, supplemented by revenue from Federal taxation (in particular, the GST).

We note the ACT Government's recently announced five year reform plan towards a fairer, simpler and more efficient tax system. The plan includes an eventual phase-out of conveyance duties (over 20 years), with the revenue to afford this to come from general rates, which the ACT is in a unique position of also levying due to its combined state and local government functions. The reforms also include abolishing duty on insurance policies over the next five years. Acknowledging this is a long-term process, the proposal recognises that reform needs to be phased-in to avoid distortions in the market.

Company tax rate

A cut in Australia's company tax rate will deliver economy-wide benefits that are necessarily in the national interest.

As a result, The Tax Institute supports reducing the company tax rate in the medium term from its current 30% to the 25% recommended by the Henry Review. In addition to increasing Australia's attractiveness as a destination for foreign investment, a 25% rate is comparable to rates in similar sized OECD countries. The Government's announced 1.5% reduction for the year ended 30 June 2016 is a step in the right direction, however The Tax Institute would encourage the Government to immediately proceed to a 2% reduction. Any such reduction should not be completely negated by a levy on some companies to support the Paid Parental Leave Scheme. Australians across the board will stand to share in the benefits flowing from a 28% corporate tax rate.

A wealth of reliable evidence indicates that the incidence of company tax falls on employees. This means that reducing the burden of company tax is expected to result in companies passing on the benefits to their employees either in the form of increased wages or additional recruitment – increasing productivity and employment.

A company tax cut would also reduce taxes on investment, driving an increase in savings and capital as well as innovation and entrepreneurship – all outcomes that are indisputably in the interests of all Australians. Such a cut would also reduce the incentive for profit shifting out of Australia, allowing us to retain a greater share of the profits generated here in Australia.

Multinational taxation

The Tax Institute recognises that the integrity of the tax base is essential to making a lowering of the company tax rate possible.

In this regard, we welcome the Government's commitment to addressing base erosion and profit shifting in conjunction with Australia's G20 partners as signalled by its endorsement of the OECD's Action Plan on BEPS in July 2013. An internationally co-ordinated effort to tackle tax avoidance and re-examine the relevance of existing source and residence doctrines of international taxation is essential to ensure that Australia's international tax system and treaty network adequately address the challenges posed by the increasingly digital international economy and levy taxation on the economic substance rather than form of the transaction.

The Tax Institute supports implementation of measures consistent with the OECD recommendations which are due to be released in September 2014 to ensure that multinational companies pay tax in the country where revenue is earned. Such measures should have additional benefits for the competitiveness of Australian-based businesses and alleviate any disproportionate tax burden on Australian households.

Nevertheless, consideration of the current activities of multinationals and any proposed changes to tax laws need to take into account the challenging and competitive circumstances faced by businesses operating in an international environment. The effect of such changes in tax laws on inbound investment and potential flow-on ramifications of changes in tax treatment by our trading and treaty partners of outbound investment need to be appropriately taken into account. Businesses should be kept informed and consulted as specific measures are proposed.

On a domestic level, we support the ongoing monitoring of Australia's bilateral treaty network and domestic tax transparency measures discussed below.

Tax transparency

Disclosure to tax authorities

The Tax Institute broadly supports efforts to increase transparency that allow tax authorities to properly understand taxpayer circumstances and apply tax laws correctly and in a timely fashion. However, this initiative should be consistent with any OECD recommendations on international tax transparency.

Any efforts to increase transparency that allow tax authorities to properly understand taxpayer circumstances and apply tax laws correctly and in a timely fashion is welcomed, but not at the cost of an increased regulatory burden. Every effort should be made to ensure that the current information gathering powers of the Australian Taxation Office are not duplicated or excessively complicated.

Public disclosure

Where the information obtained is to be disclosed publicly, it should be relevant and able to be reviewed and contextualised by the taxpayer concerned prior to disclosure. There is a high risk that the disclosed information will result in misunderstanding, especially without the necessary context about the business tax system and the particular facts and circumstances of the company. That is, the proposed disclosures risk causing widespread confusion rather than illumination, ultimately detracting from the objective of tax transparency.

Companies that have acted legally and legitimately, risk being unfairly tarred with the “tax avoidance brush” unless the Government treats disclosed information with sensitivity and takes responsibility for educating the community on the complexities of our business tax system. Exposure of company tax data on an entity by entity basis may aid, but does not in and of itself constitute, a sophisticated debate about taxation policy.

This will be especially the case for multinationals, as for such taxpayers Australia is only one of many jurisdictions in which tax is paid. The Australian tax liability of such taxpayers contributes to the organisation’s global effective tax rate and payments.

In order to protect the confidentiality of tax information of individuals and small businesses, the tax transparency threshold should be set so as to exclude as many closely held companies as possible, and at total income (as per the relevant income tax return tab) of \$250 million rather than the current \$100 million.

We consider it important to exclude as many closely-held companies as possible because the disclosure of tax information of closely held, potentially wholly-domestic companies is inappropriate and risks inadvertently disclosing details of some of the tax circumstances of the ultimate individual owners. In implementing the tax transparency objective, the need to protect the actual and in principle privacy of individual taxpayers needs to be carefully considered.

Small business

From a tax perspective, The Tax Institute has significant interest in a range of matters that affect small business, such as:

- The appropriateness of current tax policy settings intended to support small business, and resulting regulatory requirements;
- Ensuring the continuation of the significant work that remains to be undertaken in respect of simplifying existing tax laws to alleviate the compliance burden on small business. In this regard we note that compliance costs are regressive in their impact on small business;
- Exploration of the possibility of creating a separate ‘small business entity’ structure through which small business can operate and which amalgamates the benefits of existing, available structures (i.e. the company, trust, partnership and sole trader structures);
- Streamlining access to small business concessions where possible;

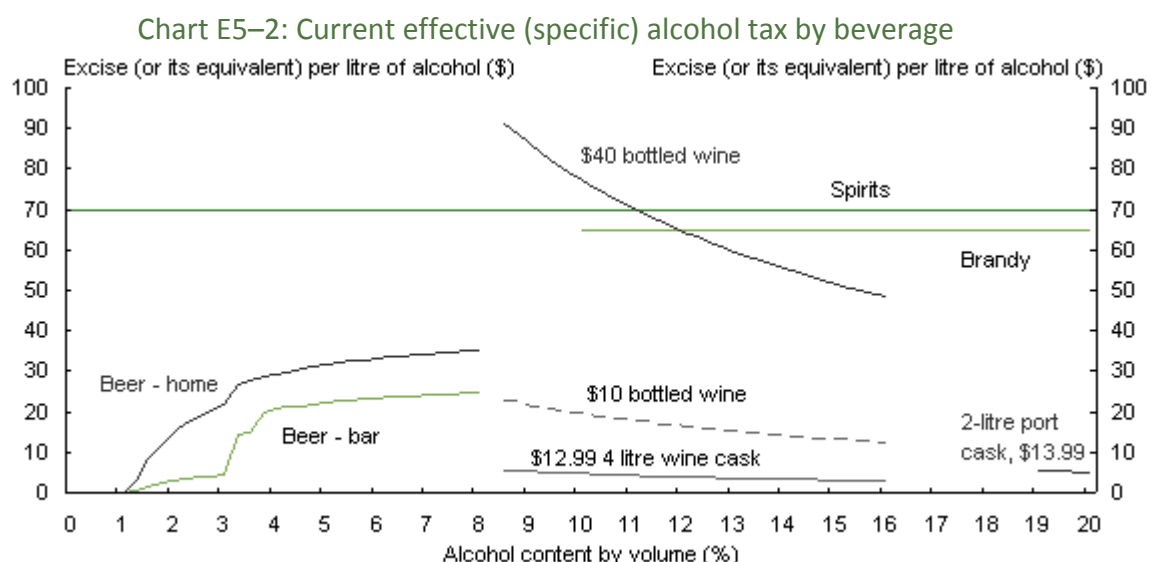
- Simplifying carry-forward loss integrity measures (the 'continuity of ownership test' and the 'same business test') in order to allow greater flexibility in capital raising and changes in business practice/operations. In this regard we note that a critical issue is the need to minimise the compliance burden and costs associated with complex integrity measures.
- Simplifying existing tax laws especially in the areas set out above including through the Board of Taxation where possible; and
- Providing greater resources to organisations such as the Inspector-General of Taxation which assist in identifying areas in which ATO processes and interactions with small business can be simplified.

Alcohol tax reform

The Henry Review found that the current system of taxing alcohol in Australia is nothing short of incoherent. There is no uniform rate of tax across all alcohol products.

Beer is taxed at eight different rates of excise duty. The rate depends on alcohol volume, type of packaging and whether the beer is produced for commercial purposes. Brandy is taxed at a separate rate to other spirits and an additional duty is applied to some imported spirits. Wine is taxed by way of a separate sales tax known as the wine equalisation tax, but smaller wineries may receive producer rebates to offset this. As wine is taxed on a value basis, this results in wines with the same alcohol content being subject to different tax rates, with cheaper wine being more lightly taxed.

This current system is simply incongruous with the goal of a simpler, fairer and more efficient tax system. The following chart from the Henry Review illustrates the complexity:



Henry Review, Part Two, Volume 2, page 437

The Tax Institute calls on the Government to further analyse and investigate the merits of reforming the current system of taxing alcohol. This would include evidence-based analysis, including consideration of transitional arrangements that might be required should a common volumetric tax be proposed.

We note that the then Government ruled out any consideration of alcohol tax reform in 2010 due to a prevailing 'wine glut and an industry restructure'. We submit that it is time to publicly consider the potential merits of reform in close consultation with the industry.

The current model of alcohol taxation has resulted from the slow accretion of contradictory policy settings over time. As a result the tax system in part influences an individual's purchasing decisions.

This may well be a desired policy outcome, in that taxes play a part in addressing the community costs of alcohol abuse. However, the Henry Review concluded that this is a blunt instrument to use and therefore must be weighed against the effect of taxing other consumers.

The Henry Review found that higher prices reduce overall consumption of alcohol products. However, in most cases a one per cent alcohol price rise produces less than a one per cent decline in consumption. The Review goes on to say: 'it is the alcohol consumed by an individual in a set period, not its value, packaging or the method or place of production, that is most closely related to social harm'. Therefore, the Review contends that alcohol taxation should be structured on a common volumetric basis across all forms of alcohol. The Government may wish to consider the impact of a common volumetric tax on health outcomes as part of a review.

Trust tax reform

The Tax Institute has long called for urgent reform of the rules governing the taxation of trusts in order to provide certainty to the hundreds of thousands of businesses (including small to medium enterprises) across Australia that operate through trusts. 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 Government's policy intent.

The Tax Institute urges the Government to pursue the reform of the taxation of trusts. Our members have repeatedly nominated this area of law as creating the greatest compliance difficulties and most in need of legislative clarification. We submit that this area of taxation should be analysed by the Board of Taxation alongside the Tax Reform White Paper process

Unfortunately, evolution in the consultation process under the former government has resulted in the canvassing of options for reform that will not yield any simplicity benefits due to excessive focus on integrity considerations.

Nevertheless, we remain committed to the reform process and hopeful of an outcome that is of mutual benefit to both the revenue and taxpayers, and yields simplicity benefits that lowers compliance costs for all.

Financial advisers providing tax advice

The Tax Agent Services Regime (TAS regime) has been operating since 2010 to ensure that tax agent services are provided to the public in accordance with appropriate professional and ethical standards. This regime is designed 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.

We welcomed the commitment the then Government made in April 2011 that financial advisers providing tax advice would become subject to the TAS regime. Extending the regime to encapsulate financial advisers providing tax advice ensures the tax advice provided in the context of giving financial advice will be restricted by the scope of a financial adviser's tax competencies.

The initial proposed start date of 1 July 2012 was already delayed by two years to 1 July 2014. Though this is now in force, there is still a generous 3 year transitional period until the TAS regime applies in full to financial advisers who provide tax advice.

The details surrounding the education and experience requirements to be captured in the regulations applying to those financial advisers required to register under the TAS regime are still under development. In the interests of consumer protection and preserving the integrity of this policy intent, we urge the Government to not accept any further delay in formulating these requirements. The sooner financial advisers (and the public) know the requirements financial advisers have to meet, the sooner assurance can be provided.

The Tax Practitioners Board will continue to play a strong role in registration and enforcement of obligations under the TAS regime. The interests of consumers remain paramount in resolving outstanding issues like education requirements, a uniform code of conduct and transitional arrangements.

In the interests of consumer protection and preserving the integrity of this policy intent, we urge the Government to ensure that the legislated start date of 1 July 2014 is maintained.

Superannuation

We encourage the Government to collaboratively construct a long-term, holistic plan for the superannuation system focussed on equity and sustainability. While the cost of the superannuation system is substantial, so are the benefits. In evaluating the sustainability of the superannuation system in the medium to longer term the Government should have regard to a range of factors, including:

- The need to respect the long term nature of the superannuation system. Many Australians have invested on the basis of existing laws for decades, in good faith and

with the belief that any changes will be implemented only when in the national interest and after taking the circumstances of existing investors into account. Such investors should not be disadvantaged by their reliance on Government to respect the long-term nature of the superannuation investment. Transitional arrangements should always be considered alongside changes that may otherwise affect existing superannuation savings that have resulted from past year contributions.

- The behavioural changes likely to result from further changes to the superannuation system. Tinkering with the superannuation system other than in line with a long-term, holistic plan will undermine confidence in the system. Current investors are likely to withhold funds and potential investors are likely to opt for other forms of investment or consumption.
- Any potential Budgetary savings stemming from changes to the superannuation system may be lesser than anticipated if this behavioural change is significant. The potential ramifications for Government finances should be carefully considered.

The Tax Institute recommends consideration of the following measures:

- Continue with the proposal to increase the superannuation guarantee to 12% over the extended 2 year time period.
- Reform penalties for employers in relation to superannuation guarantee system where the failure to pay the amount within 28 days of each quarter is due to an arguable technical position such as whether a contractor is treated as an employee.
- Reform penalties for excess contribution as the current system is unnecessarily punitive and complex. We urge the Government to consider measures such as creating scope for withdrawal within a period of time in cases of mistake and broadening the scope of the Commissioner's discretion to all cases of 'honest mistake or inadvertent omission' as akin to other parts of the income tax law.
- Increase flexibility in the contributions system by permanently increasing the contributions cap to \$50,000 for people aged over 50 and allowing taxpayers up to 75 years of age to 'carry-over' that part of the contributions cap that remains unutilised to future years and removing gainful employment tests for taxpayers over 65.
- Repeal the 10% rule in s290-160 ITAA 1997 as it is out-dated, discourages saving via superannuation by the self-employed and creates unnecessary complexity and inequity. This rule should be reconsidered as a matter of priority.
- Greater flexibility for obtaining complying status for SMSFs where a member transfers residency overseas and then returns to Australia seeking to become a resident SMSF again. Similarly, rules allowing migrants to Australia with funds in

overseas super funds wishing to bring those moneys into the Australian super system should be simplified.

Announced but unenacted tax measures

We welcome recent Government action to clear the unenacted measures backlog and prioritise the remaining unenacted measures.

All taxpayers require certainty in the identification and scope of tax laws that frame both the obligations to be observed and the liabilities which are to be paid. This includes both prevailing tax laws as well as proposed changes, regardless of the date on which the announced changes are to take effect.

Such certainty is essential to the proper functioning of our tax system for a variety of reasons, including the need to allow:

- taxpayers to self-regulate behaviour in order to minimise tax risk;
- the fostering of voluntary and informed compliance with tax laws;
- taxpayers to make investment decisions and strike commercial bargains with certainty as to the tax cost resulting from the relevant transaction;
- corporate taxpayers to make informed dividend policy decisions; and
- listed companies to produce timely financial statements that accurately reflect their tax expense.

Accordingly, the prioritised unenacted measures should be legislated as soon as possible.

In future, the Government should limit the practice of announcing an application date for legislation that precedes the date it is introduced into Parliament. While it will sometimes be necessary to announce that a legislative change will apply from the date of the announcement, particularly if the legislative change is an anti-avoidance measure or a change that is beneficial to taxpayers, the Government's default position should be that new measures take effect no earlier than the date the bill is introduced into Parliament. The previous Government would have avoided the legislative backlog if it had adopted this practice.

The Government should also continue to monitor announced measures in future to ensure that a backlog does not develop again. Relevant Government agencies, including the Department of the Treasury and the Office of Parliamentary Counsel, should have sufficient resources dedicated to implementing these measures.

We encourage the Government to pursue a model of an open, public legislative timeline. An open and transparent timeline for legislative change gives taxpayers a necessary level of certainty when it comes to dealing with that change.

It is crucial that any changes to Australia's tax system are analysed thoroughly and with due recognition of the potential regulatory and compliance impact on affected businesses and individual taxpayers. We note Treasury's critical role to ensure that tax law accurately reflects

policy intent and implementation arrangements allow for efficient and effective revenue collection.

We also urge the Government to carefully consider options to complement the decrease of resources at the ATO such as supporting greater reliance on pre-filling and/or automation of the income tax return process for taxpayers with simple tax affairs.

Deregulation

The Tax Institute supports the Government's deregulation initiative and the publishing of a regulation impact statement in respect of each tax reform. Careful consideration should be given to how the success of this initiative will be measured. It is our view that this initiative should be clearly distinguished from the repeal of redundant provisions, with the focus being on genuine time and cost savings for users of the tax system.

Further, deregulation should not be at the expense of sound reform in areas such as regulation of financial advisers providing tax advice and reform of trust taxation discussed above. The deregulation initiative should not be used to avoid addressing these complex but necessary areas requiring tax reform.

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