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2016-17 FEDERAL BUDGET *Submission*

FEBRUARY 2016

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8 February 2016

Mr Matthew Flavel
Budget Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: prebudgetsubs@treasury.gov.au

Dear Mr Flavel

2016-17 Federal Budget Submission

The Tax Institute is pleased to respond to the invitation from the Assistant Minister to the Treasurer, The Hon Alex Hawke MP, to submit our views with respect to priorities for the 2016-17 Budget.

We note that the Assistant Minister to the Treasurer has advised that the Government is 'modernising the way we deliver products and services, working to deliver a more growth friendly tax system'[1].

We welcome these commitments and trust that this submission will assist in identifying opportunities to improve tax policy outcomes for all Australians, in line with this policy direction.

This Budget Submission focuses only on those matters that The Tax Institute believes should be considered in the context of the 2016-17 Budget and does not consider longer term changes to the tax system.

About The Tax Institute

The Tax Institute is Australia's leading educator and professional association in tax, with more than 12,000 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.

[1] The Hon Alex Hawke MP, Media Release, 18 December 2015

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Despite Australia's current budgetary position, it is crucial that we do not delay the hard work on policy formulation that is required to improve our tax and transfer 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. In our view, 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, particularly having regard to the ageing of our workforce. 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. 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**.

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 2016-17 Budget. This list is not in any particular order. These issues are discussed in further detail at **Appendix C**.

Priorities for the 2016-17 Budget

Company tax reform

The Tax Institute supports reducing the company tax rate in the medium term from its current 30% rate to the 25% recommended by the Henry Review. The Government's announced 1.5% reduction for small companies in the Budget 2015-16 was a step in the right direction. The Tax Institute encourages the Government to pursue a policy position of cutting the company tax rate for all companies, not just small business companies.

Superannuation

The Tax Institute sees potential for deregulation in the superannuation sphere in measures including the repeal of the '10% rule'.

Deregulation

The Tax Institute supports the Government's continued deregulation initiative and the publishing of a regulation impact statement in respect of each tax reform.

The Australian Taxation Office should have sufficient resources to improve the digital systems it uses to communicate with tax practitioners. Tax practitioners face significant red tape as a result of outdated ATO systems.

Multinational taxation

The Tax Institute supports the Government's commitment to addressing base erosion and profit shifting (BEPS) in conjunction with Australia's G20 partners. The OECD's Final Report on the BEPS Action Plan indicates that the Government does not need to pursue any further measures related to BEPS in Budget 2016-17.

Budget 'lock-up'

Finally, The Tax Institute would welcome another invitation to participate in the Treasury stakeholder 'lock-up' on Budget night, 10 May 2016. Given that our 12,000 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 Tax Counsel, Thilini Wickramasuriya, on (02) 8223 0044.

Yours sincerely

Arthur Athanasiou
President

APPENDIX A

About The Tax Institute

The Tax Institute is Australia's leading professional association and educator in tax providing the best resources, professional development and networks. With over 12,000 members, our mission is to educate and build expertise in tax and to raise the status of the tax profession. We are committed to propelling members onto the global stage with over 7000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

Our growing membership base includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate tax content.

Established in 1943 with the aim to improve the position of tax agents, tax law and administration, Australia's tax system has since changed greatly. Likewise, The Tax Institute has evolved and become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and the taxpayer today.

Almost seven decades later, our values, friendships and the unselfish desire to learn from each other are central to our success. The Tax Institute is known for its committed volunteers and the altruistic sharing of knowledge. Members are actively involved ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.

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

2016-17 Federal Budget Submission

Company tax rate

The Tax Institute supports the reduction of the company tax rate in the medium term from its current 30% rate to a 25% rate, as 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 Organisation for Economic Co-operation and Development (OECD) countries. The Government's announced 1.5% reduction for small business from 1 July 2015 is a step in the right direction. However, The Tax Institute encourages the Government to pursue a cut in the company tax rate for all companies, not just small business companies.

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 cut in the company tax rate would also reduce taxes on investment, increasing the incentives for 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.

Superannuation

The Tax Institute notes the recent comments by the Treasurer that the Government may proceed with tax reform (including reform to the superannuation system) prior to the release of the Green and White Papers.[2] The Tax Institute urges the Government to delay any major changes to the tax and superannuation systems until after the release of those papers. It is important that any changes be effected holistically taking into account the tax, superannuation and transfer systems.

It is noted that the superannuation system has been under constant change for over 20 years and that each change undermines taxpayers' confidence in the superannuation system and discourages people from saving for their retirement. The position of The Tax Institute is that any changes to the superannuation system should be based on the current review process to ensure that such changes effect, and can be "sold" to the general public as, a holistic and principled change to the system. The Tax Institute believes that this cannot be achieved by narrow or piecemeal changes to the superannuation system.

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[2] http://sjm.ministers.treasury.gov.au/transcript/007-2016/

Consequently, The Tax Institute has confined this budget submission to areas where it considers immediate action is required to “reduce red tape”. This includes:

1. Abolishing the “10% rule” for personal concessional contributions. This rule creates considerable red tape, is complex and is no longer applicable given our current system. We discuss this point in detail below and would be pleased to expand on any of the other points below if and when needed.

2. Allowing greater flexibility for obtaining (or retaining) complying status for SMSFs where a member transfers residency overseas and then returns to Australia seeking to become a resident SMSF again. A simple change that we favour is the removal of the active member test as this test can result in an outcome where a fund loses its complying status because a member contributes while a non-resident even where they retain strong connections to Australia. The basis of this rule is presumably to limit use of superannuation taxation rules to those without a strong connection to Australia. The other tests for residency in our view already establish that connection.

3. Similarly, the rules allowing migrants coming to Australia with funds in overseas superannuation and like funds to bring those overseas savings into the Australian superannuation system should be simplified. These measures will increase Australia’s competitiveness by ensuring that superannuation is not a barrier to preventing the inbound and outbound movement of people in an increasingly mobile world. Also, Australia should benefit from the increased savings that should flow into Australia rather than being ‘stuck’ overseas due to the tax impost that would otherwise apply on bringing the money to Australia. Currently, there are contributions caps that limit the flow of inbound superannuation fund money and other uncertainties that relate to the current Div 305 of the 1997 Act.

4. Increasing the contribution caps for persons over 50 (many who have not accumulated much due to broken work patterns or being lumbered with family costs and no prior savings potential).

5. Allowing members aged 65 plus to make contributions without having to satisfy any gainful employment test. Currently this test requires these members to work 40 hours in 30 consecutive days. Often this test is satisfied in a somewhat artificial manner. This is leading to distortions as, more and more people are working beyond 65 years given longer life expectancies, rising costs of living, lower real returns on investments and to sustain their lifestyles.

6. Allowing people aged 75 and over to make contributions where they have a limited balance in superannuation. Although this may be an issue that could be considered in the Tax Reform Options (Green) Paper, The Tax Institute encourages the Government to consider introducing some flexibility in the interim.

7. Reforming penalties for employers in relation to the superannuation guarantee system where the failure to pay the amount within 28 days of the end of each quarter has such severe consequences. Even where a worker requests to have the amount paid to them as a contractor, where the failure results from a technical position such as whether a contractor should be treated as an employee, the employer can be liable for large amounts, have multiple

levels of penalty and no deductions for the charge amounts. Furthermore, the calculation rules can be complex such as what is to be included in ordinary time earnings as certain items are included and some are not. As explained in our submission to Treasury dated 21 September 2015,[3] recent proposals to reform the SG penalties do not go far enough.

8. Providing a "safe harbour" for the terms of related party limited recourse borrowing arrangement ('LRBA') loans entered into by superannuation funds. The ATO has taken the view that a "non-commercial" LRBA loan triggers the application of the non-arm's length income rules. The ATO has also indicated, in order to establish that the LRBA loan is on commercial terms, that related party LRBA loans must be benchmarked against what is available on the market (and that such benchmark material must be retained by the SMSF trustee). The Tax Institute supports the position that related party LRBA loans should be on commercial terms, however, we are concerned that the benchmarking requirement is often difficult in practice to achieve given the various loan arrangements on offer with different terms and conditions. It is therefore too onerous on taxpayers and can lead to uncertainty. The Tax Institute recommends that "safe harbour" provisions be introduced, setting out certain terms under which a related party can lend to an SMSF without triggering the non-arm's length rules. For example, the safe harbour rules could set out a minimum interest rate.

9. Division 293 of the 1997 Act is a relatively complex model for attempting to address perceived inequities in the taxation of superannuation contributions, and its operation should be reviewed.

Detailed submission on the reasons for the abolition of the 10% test

The following is an extended explanation as to why the 10% rule should be abolished.

The "10% rule" refers to the limitation of deductions for superannuation contributions to self-employed Australians who earn less than 10% of their earnings from employee activities. Currently, an employee who earns more than 10% of their earnings from employee activities is generally limited to the minimum superannuation guarantee level of support (currently 9.5%) based on their salary and wages. This is encapsulated in section 290-160 of the 1997 Act.

The Tax Institute sees potential for deregulation in the superannuation sphere by repealing section 290-160 of the 1997 Act. The 10% rule should be repealed 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.

The 10% rule costs a considerable amount to administer and requires significant documentation to be completed, neither of which adds any value. Superannuation funds would be saved an unnecessary cost and impediment if this rule was repealed. The Cooper Review adopted and confirmed the Henry Review recommendation that legislation should be amended to remove trustee administrative burdens that are identified as unnecessary.

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[3] http://www.taxinstitute.com.au/tisubmission/simplifying-and-reducing-the-harshness-of-the-superannuation-guarantee-charge

The 10% rule was originally introduced in light of factors that are no longer relevant, including the fact that previously contribution limits operated on a per employer / contributor basis, rather than per individual. The 10% rule was a mechanism to ensure that individuals earning substantial passive income as well as employment income didn't benefit from double super contributions. This policy rationale is no longer relevant since the removal of employer / contributor based deduction limits in mid-2007. Since these changes, the superannuation rules now rely primarily on contribution caps per individual, which apply in the same way to the self-employed (and unemployed) compared to employees.

Furthermore, the current rule also prevents many self-employed from taking full advantage of their concessional contributions cap. The rule results in an arbitrary limit which is inequitable and discourages voluntary contributions as no deduction exists when the 10% rule is breached and such taxpayers fall outside the bounds of the co-contribution scheme.

A number of employment situations result in the need to consider the 10% rule (and therefore resulting in the predictable behavioural responses of reduced contributions and workforce participation). For example, a doctor who gains a visiting medical officer role at a hospital can easily lose their entire ability to claim for a superannuation contribution if they exceed the 10% rule. This makes it harder, especially for regional and country hospitals, to gain valuable input from the self-employed. Another example is where individuals move in and out of employment and self-employment arrangements during a financial year (often typical with those who work on short term contracts and projects).

As the contribution cap is an individual taxpayer limit, there is no longer a requirement to restrict individuals from the ability to make personal contributions to superannuation and claim a deduction. Whether they salary sacrifice from employment or make contributions and claim a deduction, they are limited to total contributions of $30,000 / $35,000 before there is an excess, making the 10% rule inappropriate.

The 10% rule should be removed to encourage the self-employed (and other eligible taxpayers) to contribute towards their own retirement in a timely and sustainable fashion, that is, throughout their working lives. Without this change, there is little incentive for a self-employed or unemployed taxpayer to contribute voluntarily towards their own retirement funding. There is also a category of taxpayers who through no fault are unable to make concessional contributions and may in fact have no employer support as they may not meet superannuation guarantee requirements due to small amounts of salary and wage income.

By repealing section 290-160 of the 1997 Act, a taxpayer will be entitled to claim a tax deduction for their personal superannuation contributions irrespective of their employment status – whether employed, self-employed or both employed and self-employed. The control mechanism for the tax deduction will then simply be the concessional contribution cap applicable to the taxpayer.

Deregulation

The Tax Institute supports the Government's continued 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. The measurement should take into account costs reduced in the system as a whole, as opposed to the shifting of costs from one participant in the tax system to another. 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 used to avoid addressing these complex but necessary areas requiring tax reform.

Multinational taxation

The Tax Institute supports Government's commitment to addressing base erosion and profit shifting (BEPS) in conjunction with Australia's G20 partners. The OECD's Final Report on BEPS released on 5 October 2015 indicated that Australia's existing tax system is broadly consistent with international best practice on BEPS. Introducing measures relating to BEPS in Budget 2016-17 would result in Australia moving beyond internationally co-ordinated efforts, and would introduce further complexity and uncertainty to the tax system.

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 adequacy of Australia's current laws

Australia is renowned for having one of the most complex and robust tax systems in the world. This complexity creates great difficulty for taxpayers to navigate their way through the system to determine what their obligations may be under the Australian tax law. However, the robustness serves to markedly reduce the opportunity for a taxpayer to not comply with their obligations.

Australian registered corporations are incentivised to pay corporate income tax in Australia as a result of the operation of Australia's dividend imputation system. This positively influences tax revenue collection from Australian corporate taxpayers and therefore assists to increase revenue collection in Australia, given that corporate income tax paid is effectively a "forward payment" of income tax payable by shareholders.

Australia has most recently seen a further tightening of aspects of its tax laws to target tax avoidance directly and indirectly, which apply to both Australian registered corporations and multinational corporations operating in Australia. This has included changes to its general anti-avoidance provisions[4], and in respect of international dealings, a tightening of its thin capitalisation rules,[5] new transfer pricing rules,[6] introduction of country-by-country reporting,[7] and a specific multinational anti-avoidance law.[8]

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[4] Part IVA of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**)

[5] Division 820 of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**)

Currently, there are co-ordinated efforts by the OECD countries to address BEPS, a concern that has been widely acknowledged by OECD countries, including Australia. We support Australia's involvement in this work and in particular, the work in the area of the digital economy to address the gaps that exist that allow for double non-taxation, that is, income wherever sourced not being appropriately taxed in any jurisdiction. The OECD's Final Report on BEPS Action Plan released on 5 October 2015 indicates that the Government does not need to pursue any further measures related to BEPS in Budget 2016-17. This is evident in the Treasurer's Media Release dated 6 October 2015, which indicated that the only further work on implementation is to sign a multilateral instrument pursuant to OECD Action Item 15.[9]

Other matters – resources

Relevant Government agencies, including the Department of the Treasury and the Australian Taxation Office, should have sufficient resources dedicated to implementing tax measures. 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 also urge the Government to carefully consider increasing resources at the ATO to improve the online systems it uses to communicate with tax practitioners. Tax practitioners, who are responsible for the vast majority of tax returns lodged in Australia, continue to face daily inefficiencies arising from outdated ATO systems such as the Tax Agent Portal. We have concerns as to the progress that has been made in relation to these ATO systems.

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[6] Division 815 of the 1997 Act
[7] Subdivision 815-E of the 1997 Act
[8] Section 177DA of the 1936 Act
[9] http://sjm.ministers.treasury.gov.au/media-release/003-2015/