

BUSINESS COALITION FOR TAX REFORM

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Budget Submission to the Federal Treasurer

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Introduction

The Business Coalition for Tax Reform (BCTR) is a forum for bringing together the views of the business community on tax reform issues. BCTR members share the common objectives of creating and implementing a better tax system that enhances both international and domestic business competitiveness and fairness and which assists in creating a business climate conducive to investment, growth, job creation and private saving. A list of BCTR members is provided in Attachment A. The BCTR web site can be found at www.bctr.org

Tax Reform Priorities

The BCTR maintains an active interest in the implementation of the New Tax System tax reform measures and continues to promote understanding of the reasons for further reform and to provide input into the implementation process.

The BCTR aims to promote 10 principles for Australia's taxation system. These are set out in Attachment E to this submission. While much has been achieved in recent years in the tax reform arena, the task is ongoing with much still to be done. If we are to meet the objectives outlined above, Australia cannot afford to rest here, nor can Governments afford to restrict their consideration of taxation reform to business taxes levied at the Federal level and the domestic taxpayer. The BCTR encourages both Federal and State Governments to take a renewed interest in tax reform and to do so from a 'whole of economy' perspective. The best taxation system for sustained long-term economic growth requires that all levels of taxation in Australia are working efficiently and facilitating Australia's international competitiveness. Furthermore, that the tax system meets not only the challenges of today but those likely to arise in the future.

Here, *revenue adequacy* will be of paramount importance. With an ageing population and rising cost of meeting health and welfare needs, the pressure will be there to increase the level of taxation. The risk is that if this is undertaken hastily in a crisis type environment, the resulting tax policy response will probably not be in Australia's long term interest.

The BCTR encourages the Government to build on its Intergenerational Report 2002-03 and the recent work of the Productivity Commission to develop a vision for Australia's tax system which will serve the country well as it confronts the *twin challenges* of an ageing population and increasing international competition.

Despite some seven years of tax reform, there is still much tax reform left undone. With the Government to have a majority in both Houses of Parliament from 1 July 2005, the time is right to consider how best to make those hard long term decisions which are essential to positioning Australia as a competitive player in the global economy with a robust tax system.

The BCTR has a substantial interest in the efficient operation of the tax system and business tax reform remains a significant policy issue. The BCTR believes that broad Australian taxation reform is fundamental in providing a framework for sustainable business productivity and Australia's long term economic growth and prosperity. Priority should be given to:

- the overhaul of Australia's personal tax system;
- further state taxes reform;
- implementing the remaining outstanding business reform measures arising from the *Review of Business Taxation* in 1999 including blackholes, at-call loans, leases and rights, TOFA, loss usage rules and fine tuning the tax consolidation and uniform capital allowance regimes to ensure technical issues are addressed pragmatically and fairly and in a timely fashion;
- further business tax reform in order to maintain and enhance our international competitiveness and growth; and
- reduced compliance costs for all including relevant Government agencies such as the Australian Taxation Office.

The policy recommendations of the BCTR arise from the work of its sub-committees of which there are four, covering the issues of personal tax reform, State tax reform, international tax and tax administration.

In its 2005 Budget deliberations, the BCTR encourages the Government to consider the findings of these four working groups which consolidate the collected views of some of Australia's leading industry organisations. Their key recommendations to Government for its consideration in the 2005 Budget are outlined below.

Personal Income Tax

The Government should undertake a review of the personal tax system.

Reforming aspects of the personal income tax regime (such as high marginal tax rates and high effective marginal tax rates) is very important for business because they can:

- impact unfavourably on workforce participation, skills acquisition, training and labour turnover, and in particular:
 - inhibit Australia's ability to attract and retain labour in the internationally mobile segments of the labour market;
 - interact with the welfare system to pose a major disincentive to those on low incomes to supply more (or any) labour.
- impact unfavourably on the cost of labour as a business input when labour attempts to maximize their take home pay in an inflationary environment;
- represent a serious barrier to personal saving and discouraging investment;
- tax unincorporated small businesses at very high rates;
- tax profit distributions at high rates; and
- encourage wasteful creative activities designed to minimise tax liabilities.

The BCTR is preparing a paper on personal tax reform options for public release in the coming months. One strategy under consideration by the BCTR and perhaps an option for Government would be a Green Paper/ White Paper approach. In this case, Government would first prepare a *Green Paper* outlining tax reform options which will help enlist both business and community support for further major tax reforms. A *White Paper* would then be released outlining reforms to be introduced and the proposed implementation timeline.

See Attachment B for more detail.

State Tax Reform

The reform of State taxation is a high priority.

The first step in reforming State and Territory taxes should be to complete the tax reform program foreshadowed by the State and Territory Governments and the Commonwealth as part of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations of 1999 (the IGA). The removal of inefficient State and Territory taxes other than those listed in the IGA (such as duties and charges on insurance premiums) is also a priority.

As discussed further in Attachment C, all States and Territories have the capacity to remove at least some of the remaining IGA taxes from 1 July 2005. Some States and Territories have the capacity to removal all the remaining IGA taxes from July 2005. As a minimum all States and Territories should remove all remaining IGA taxes as soon as they have the financial capacity to remove these taxes from their shares of the growing GST revenue.

The BCTR recognises the primary responsibility for the removal of the remaining IGA taxes rests with the States and Territories themselves. At the same time, the Commonwealth, as the initiator of the IGA and in the interests of national welfare, can play a constructive and facilitative role in forging a more thorough and timely removal of these taxes.

Accordingly, the BCTR urges the Commonwealth to allocate the additional income tax collections it stands to receive as a result of the removal of the IGA taxes to finance a program of incentives structured to encourage and facilitate the removal of the remaining IGA taxes and further reform of inefficient State and Territory taxes.

See Attachment C for more detail.

International Tax

Further international tax policy changes are necessary to consolidate and enhance recent important reforms.

The BCTR considers that reforms in the following areas are particularly important:

- *Temporary Residents:* Reforms abandoned following Senate opposition in December 2003 should be reintroduced.
- *Taxed Foreign Income:* Foreign profits subject to foreign tax when distributed to Australian resident shareholders are taxed at high rates. The BCTR supports the Board of Taxation's recommendation for a non-refundable tax credit of 20% as an appropriate way of addressing this issue.
- *Dividend imputation:* This system should be retained in its present form as an effective way of removing the double taxation of dividends.

As the world becomes increasingly globalised and integrated, Australia *must* give priority to removing the capital bias against Australian companies expanding and growing in global markets. The BCTR supports the retention of the dividend imputation system in its present form as an effective way of removing the double taxation of dividends for domestic shareholders. As the world becomes increasingly globalised and integrated, however, Australia cannot afford not to remove the capital bias against Australian companies expanding ad growing in global markets and provide some form of recognition of foreign tax paid on foreign profits ultimately distributed to Australian shareholders

See Attachment D for more detail.

Tax Administration

Tax administration should operate effectively and with minimal compliance costs for taxpayers.

Tax administration and compliance costs impose substantial burdens on business and the community in general. However, the BCTR acknowledges the Government's public commitment to reducing these burdens as evidenced by their support for the Board of Taxation (in particular the post-implementation review of tax legislation), the Review of Income Tax Self-Assessment and the activities of the Inspector-General of Taxation.

In relation to the Inspector-General of Taxation, the BCTR notes the Inspector-General is currently undertaking three specific reviews, into:

- the Tax Administration of GST Refunds Arising from the Lodgement of Business Activity Statements;
- the ATO's Small Business Debt Collection Practices; and
- review into Aspects of the Tax Office's Business Active Compliance Activities.

The BCTR welcomes these reviews, particularly the review into Aspects of the Australian Taxation Office's Business Active Compliance Activities. BCTR members are concerned that in many instances such compliance activities are time consuming and costly and can sometimes result in significant penalties, which can be applied in an inconsistent manner.

The BCTR stresses on Government the long term strategic importance for Australia of simplifying its tax system and reducing compliance costs and encourages it to remain committed to these tasks not only through administrative reforms, but through tax policy reforms.

Attachment A Business Coalition For Tax Reform (BCTR) Members

Australian Food and Grocery Council

Australian Industry Group

Australian Institute of Company Directors

Australian Retailers Association

Australian Stock Exchange

Business Council of Australia

Corporate Tax Association of Australia

CPA Australia

Council of Small Business Organisations of Australia

Federal Chamber of Automotive Industries

International Banks & Securities Association Australia

Insurance Council of Australia

Investment and Financial Services Association

Master Builders Australia

Meetings Industry Association of Australia

Minerals Council of Australia

Property Council of Australia

Real Estate Institute of Australia

The Institute of Chartered Accountants in Australia

Attachment B Personal Taxation

Given Australia's strong reliance on personal taxes as a source of revenue, we need to review our personal tax system to ensure it is fair, efficient and internationally competitive. Perhaps most importantly, it should be structured to meet the economic and social challenges presented by the ageing population and increasing international competition for markets and resources.

In a business context, Australia's personal tax system is important because it has the potential to impact on business growth prospects (and therefore economic growth). This can occur in the following ways and it is imperative that they be addressed:

1. *Australia's high marginal and high effective marginal tax rates impact unfavourably on workforce participation, skills acquisition, training and labour turnover.* These impacts are becoming even more critical as we face an ageing population and potential declines in overall workforce participation. The BCTR is particularly concerned that these work-related tax distortions currently occur at relatively low rates of income - especially for those subject to the 43.5% and 48.5% rates (including the Medicare levy). And this is even after the recent changes to the threshold at which these thresholds come into effect (at \$A58,000 and \$A70,000 respectively). These rates detract from the rewards and incentives for higher levels of workforce participation.

The high effective marginal tax rates (EMTRs) applying due to the interactions between the income support system and the income tax system spread these work disincentives to other segments of the population. The withdrawal of the Family Tax Benefit (Part A) (FTBA) is a significant contributor to this with many parents in middle-income families experience EMTRs of 51.5% due to the combination of the FTBA income test, personal income tax and the Medicare levy.

The combination of personal tax rates and income tests applying to other income support payments can have the added disincentive of perpetuating welfare dependency by reducing the benefits of participation in the workforce. Unemployed people, disability pensioners, sole parents and age pensioners with opportunities for part-time work all experience an erosion of financial incentives to work as a result of the high effective marginal tax rates.

2. *High marginal tax rates and high effective marginal tax rates represent a serious barrier to personal saving.* For many Australians, particularly those in a position to save, high marginal tax rates remove the possibility of earning a positive real rate of return from a regular saving account.

3. *Labour is increasingly bargaining for post-tax wage increases rather than gross wage increases.* This impacts unfavourably on the cost of labour as a business input because the attempts to maximize take home pay impact directly on gross labour costs.
4. *Tax reform has reduced the company income tax rate which is currently an internationally competitive rate (albeit funded from the removal of other business tax measures, notably 'accelerated' depreciation) but the tax rates applicable to unincorporated small businesses are very high as are the personal tax rates that apply to the distributed income of the shareholders of incorporated businesses.* Most small businesses in Australia are sole traders, partnerships or trusts where their income is subject to tax at personal marginal rates of the owners/operators. While some small businesses choose to also operate private companies and thereby avail themselves of timing benefits with the 30% company tax rate, the distribution of these profits to the owners is subject to tax at personal marginal rates. The high marginal rates act as a disincentive for businesses to grow as the profits become subject to much higher marginal rates of tax.
5. *The personal tax system creates particular barriers that inhibit Australia's ability to attract and retain labour in the internationally mobile segments of the labour market.* However the disadvantages for Australia are not limited to the access to workers themselves. The personal tax system adversely affects Australia's international competitiveness as a location for R&D, regional management centres or other specialised units of multinational enterprises where specialised labour is the key ingredient. Australia therefore misses out on the broader benefits of having these facilities located in Australia.
6. *Australia's personal tax system gives rise to a variety of distortions, misallocations of resources, arbitrage opportunities, avoidance and evasion incentives and increased costs for Australian business.* For example, the very large gap between the top personal rate of 48.5% (including the Medicare levy) and the company tax rate of 30% creates an incentive to derive what would otherwise have been personal income through a company structure. Anti-avoidance measures to address these distortions add to the complexity of the tax system and impose compliance costs on business. One example is the 1980s and 1990s PAYE erosion and shift to contractor status that attracted attention in the *A New Tax System* reforms in the form of the personal services income (PSI) provisions. Such measures are inherently difficult to design and enforce. They also attack the symptoms and not the disease. Another example is the proliferation of the tax-driven investment schemes we have seen over the last decade.

7. While high MTRs are an issue for upper income groups, as was noted earlier, the *effective marginal tax rates (EMTRs) resulting from the interaction of the income tax and the social welfare system for those on low wages and salaries or on welfare, poses a major disincentive to supply more (or any) labour.* This must be addressed because it has the potential to impact on the long term sustainability of our taxation and Government expenditure system through it acting to deny the economy access to scarce resources necessary for sustained future growth.

The BCTR is currently considering options on how our personal tax system should be reformed to meet the economic and social challenges we face over the next 40 - 50 years. A discussion paper on personal taxes will be released in the coming months. One strategy we are supportive of and encourage the Government to consider in this regard is the release of a *Personal Tax Reform Green Paper* outlining the reform options which will help to enlist both business and community support for major reforms in this area. Following community consultation, a *Personal Tax Reform White Paper* should be released detailing the reforms to be introduced as well as a proposed timeline for implementation.

Attachment C Reform of State Taxation

The reform of State taxation remains one of the BCTR's leading priorities.

The immediate objective of the BCTR in the reform of State taxes derives from the introduction of the Goods and Services Tax in 2000. Under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations of 1999 (the IGA), the Commonwealth, the States and Territories agreed to a program for the reform of State and Territory taxes. This reform program has several steps:

1. Some State and Territory taxes have already been removed. These include the Accommodation levies, the stamp duty on quotable marketable securities and the Financial Institutions Duties.
2. The Bank Account Debits taxes either have been removed or will shortly be removed.
3. The need for the States and Territories to retain another set of taxes is currently under review. This includes a variety of stamp duties (for example on mortgages, leases, and commercial conveyances).

The BCTR commends the steps that have already occurred as a result of this program (and the additional steps that individual States and Territories have taken independently).

The final stage in the implementation of the State tax reform program outlined in the IGA is the removal of the remaining IGA taxes. These taxes are currently under review and will be considered by the Ministerial Council of Australian Treasurers prior to the 2005-06 Budget.

The BCTR commissioned Access Economics to estimate the ability of the States and Territories to remove the remaining IGA taxes and the impact of their removal. Using information contained in the Access Economics report the BCTR wrote a submission to all Australian Treasurers drawing attention to the following facts:

1. All the States and Territories can afford to remove at least some of the remaining IGA taxes as a result of their improved total revenues under the financial arrangements put into place as a result of the IGA;
2. Some States and Territories can afford to removal all remaining IGA taxes from July 2005;
3. The capacity of the remaining States and Territories to removal additional IGA taxes will improve over the next couple of years;
4. To the extent to which State and Territory taxes are removed, the Commonwealth will receive greater income tax collections because of the removal of a source of deductions against assessable income; and

5. This prospective extra revenue for the Commonwealth is a potential source of funding for a program of more timely and thorough removal of the IGA taxes than could be achieved if funding were limited to the extra revenue the States and Territories stand to receive under the IGA.

The BCTR Submission and the Access Economics report are available at www.bctr.org

The BCTR recognises the primary responsibility for the removal of the remaining IGA taxes rests with the States and Territories themselves. At the same time, the Commonwealth, as the initiator of the IGA, can play a constructive and facilitative role in forging a more thorough and timely removal of these taxes.

Accordingly, the BCTR urges the Commonwealth to allocate the additional income tax collections it stands to receive as a result of the removal of the IGA taxes to finance a program of incentives structured to encourage and facilitate the removal of the remaining IGA taxes.

Attachment D International Tax

The BCTR commends the Government for continuing with the implementation of the international tax reform measures announced in May 2003. These policy changes are helping to improve the international competitiveness of Australian businesses, large and small. We acknowledge the ongoing consultation process, which we understand should culminate in the introduction of a number of further specific measures in the next Parliamentary sittings. These measures include the foreign income account, the taxation of employee share options and other measures.

A number of further policy changes in this area would consolidate and enhance this position.

Temporary Residents

The Government is urged to revisit the package of measures that was abandoned in December 2003 in the face of Senate opposition. These measures included a four-year exemption in respect of most foreign source income (including capital gains) for first-time temporary residents.

If anything, the skills problems facing Australian business have exacerbated since these measures were abandoned, and the Government should reintroduce them at the earliest opportunity.

Taxed Foreign Income

The BCTR continues to be concerned about the very high level of taxation on foreign profits that have been subject to foreign tax which are distributed to Australian resident shareholders. These outcomes impact adversely on the cost of capital for Australian based multi-national companies.

In our view, the Board's recommendation of a non-refundable tax credit of 20% represents an appropriate way of addressing this issue, particularly having regard to the decision by the Government not to proceed with its earlier announcement that it would provide imputation relief in respect of foreign withholding tax at an annual cost of approximately \$180 million.

This is an issue that needs to be addressed before it becomes less manageable in budgetary terms as over time an inevitable consequence of globalisation will result in Australian based multi-nationals' foreign earnings increasing, which will result in the need for these companies to access taxed foreign earnings in order to satisfy dividend demands.

Internationally, Australia's policy position on this issue is increasingly becoming that of the odd-man out, with most developed countries now providing tax relief in respect of dividends

received by resident individuals in ways that do not discriminate against taxed foreign income.

The BCTR supports the retention of the dividend imputation system in its present form as an effective way of removing the double taxation of dividends for domestic shareholders. As the world becomes increasingly globalised and integrated, however, Australia cannot afford not to remove the capital bias against Australian companies expanding and growing in global markets. The BCTR supports the retention of the dividend imputation system in its present form as an effective way of removing the double taxation of dividends for domestic shareholders. As the world becomes increasingly globalised and integrated, however, Australia cannot afford not to remove the capital bias against Australian companies expanding and growing in global markets and provide some form of recognition of foreign tax paid on foreign profits ultimately distributed to Australian shareholders

Attachment E BCTR 10 principles for Australia's taxation system

The BCTR aims to promote 10 principles for Australia's taxation system. These are:

1. The tax system should be simple, transparent and should minimise uncertainty.
2. The design, administration and operation of the tax system should be undertaken with full and effective consultation with relevant stakeholders including the business community.
3. The tax system should fairly balance the need to protect the taxation revenue base with the principles of a good tax system, i.e. efficiency, fairness (horizontal and vertical equity), simplicity, clarity, certainty and low compliance costs.
4. The tax system should enhance competitiveness by providing a climate conducive to improved investment in Australia and from Australia for Australian-based entities and individuals.
5. Indirect taxation at the state and territory level should be more efficient and competitive.
6. The pattern of Federal/State financial relations should be transparent, efficient and sustainable.
7. The tax treatment for savings should be consistent with an overall savings policy that encourages the sustainability of strong, ongoing growth.
8. The tax, and social security, treatment of personal income and fringe benefits should conform to the principles of fairness, efficiency and simplicity.
9. The tax system should avoid the double taxation of business income and provide relief for all business expenses.
10. The tax system should not impede organisational restructuring.