

**Business
Coalition for
Tax
Reform**

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AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: AFTSubmissions@treasury.gov.au

Dear Sir / Madam

SUBMISSION – HENRY REVIEW CONSULTATION PAPER

The Business Coalition for Tax Reform (BCTR) is a forum that brings together the views of the business community on tax reform issues. BCTR members share a desire to develop a unified business approach to building a better taxation system that enhances both international and domestic business competitiveness and fairness, and which assists in creating a business climate that is conducive to investment, growth, job creation and private saving.

A list of BCTR member organisations is contained in Appendix B.

The BCTR is pleased to provide its comments on the Consultation Paper released by the Australian Treasury in December 2008 as input to the "Australia's Future Tax System" (AFTS) review that was announced by the Treasurer in May. Our broad submission is attached as Appendix A.

While the submission addresses a number of the specific questions raised in the Consultation Paper, it should be read in the context of the BCTR/Centre of International Economics report on State taxes, which is also attached. In the BCTR's submission, the tax mix changes recommended in that report represent an excellent opportunity to optimise economic growth through reforming the tax system. The BCTR's comments on other issues raised in the Consultation Paper should be seen as additional opportunities to improve Australia's growth prospects.

In the event you have any questions regarding the matters canvassed in the submission please do not hesitate to contact me on 03 9634 9901, or Frank Drenth on 03 9600 4411.

Yours faithfully



John Stanhope
Chairman

Appendix A

**SUBMISSION
AUSTRALIA'S FUTURE TAX SYSTEM CONSULTATION PAPER
BUSINESS COALITION FOR TAX REFORM**

The BCTR regards the AFTS' Consultation Paper as a further useful step in focusing the submissions received in relation to its earlier Architecture Paper into more specific questions for stakeholders to respond to in helping the Review frame its recommendations for tax reform for the government later this year.

As mentioned in our covering letter, this submission should be read in the context of the BCTR/CIE study on reform directions for State taxation which accompanies this broader submission.

In drafting this further submission the BCTR has taken into account the contents of the Consultation Paper, various public comments made by Dr Henry as chair of the Review, as well as other public debate around tax reform that has taken place in recent months. We have not attempted to address every single question posed in the Consultation Paper – rather, this submission concentrates on the issues considered by our member organisations to be of common significance for business.

Without revisiting our earlier submission in any detail, we thought it might be helpful to again summarise the main issues that we touched on there. These included:

- The need to review the tax treatment of capital allowances to help improve international competitiveness – in particular for intangibles.
- The rules governing entity losses.
- The position of taxed foreign earnings that are distributed to Australian shareholders.
- The taxation of interest and interest like returns in the hands of individual taxpayers.
- Simplifying FBT and the optional use of accounts for reporting entities.
- Addressing the Federal/State fiscal imbalance, possibly by the transfer of another source of revenue to the States.
- Centralising the administration of and harmonising remaining State taxes.
- ATO governance, including the need for an oversight board.

Subject to what follows, the BCTR's views about these important issues remain largely as set out in our earlier submission.

The BCTR's submission to the Review's Architecture Paper in October 2008 also set out a number of principles which we consider should be reflected in a well designed tax and transfer system. Without reproducing here all the specific policy settings that would be consistent with those principles, it may be worth restating them hereunder:

1. *The design of the tax system should result in a robust and stable revenue base.*
2. *The tax system should support Australia's international competitiveness and support a growing and vibrant business sector, and minimise the tax administration burden on all businesses.*
3. *The tax-transfer system should, to the maximum extent possible, be consistent with broader government policy objectives in areas such as climate change, the emissions trading system, population policy, globalisation and technological change.*
4. *The design of the tax-transfer system should endeavour to minimise distortionary effects on behaviour, including workforce participation, rates of saving, and engagement in entrepreneurial and commercial activities. It should also be consistent with the traditional principles of equity, simplicity (or eliminating unnecessary complexity) and efficiency.*

5. *Where the design of the tax-transfer system involves making trade-offs between competing policy objectives, this should be done in an open and transparent way.*
6. *The design of the tax-transfer system should be flexible so that it can adapt to changing domestic and international circumstances.*
7. *To the maximum extent possible, the most inefficient of taxes levied by the commonwealth, state, territory and local governments should be removed.*
8. *The imbalances between the spending responsibilities and revenue raising powers of the different levels of government should be addressed in a way that is simple, transparent and provides sufficient certainty for each level of government.*
9. *States should be financially motivated to improve efficiencies in service delivery, to ease administrative burdens and duplication of effort for taxpayers and to remove inefficient taxes.*

Economic growth vs. distribution

The Consultation Paper sets out in some detail the conflicting recommendations received from various stakeholders on aspects of Australia's tax and transfer system. Not surprisingly, some of these recommendations focus more on distribution and social justice aspects than on economic growth. The BCTR understands and respects those views.

While it might sometimes appear that these objectives are mutually exclusive, we would argue that when looking at the bigger picture they are not. There will always be legitimate debate about the level and incidence of taxes and transfers, whatever the level of wealth of a country at a given point in time.

Generally speaking, however, a wealthier society will always be better placed to effectively address social justice, environmental and other concerns. Accordingly, the BCTR strongly supports tax reform that will promote economic growth. This includes changes to the tax mix such as the State tax reforms outlined in the BCTR/Centre of International Economics report and reductions in capital taxation since those measures are more likely than some other options to lead to improved economic growth.

Company income tax

We note the public comments made by both Dr Henry and the Treasurer, Mr Wayne Swan, about the likely incidence of company income tax as indicated by the academic research (it is thought to fall mainly on labour, shareholders and consumers), and the expectation that cutting the company income tax rate is more likely to boost economic growth than most other cuts in direct taxation. Added to that is the international trend in company income tax, which has remained downwards notwithstanding the current economic crisis.

Whether the current budget position will be judged as being able to accommodate this kind of investment in growth remains to be seen. However, the economic crisis will eventually pass and it will ultimately be a matter for the government to decide where it wants to position itself in terms of competitiveness and growth.

We also note the discussion in the Consultation Paper of a number of alternative ways of taxing entities, including a form of cash-flow taxation and a notional allowance for corporate equity (ACE). Taxing economic rents is another area that might be further investigated by the Review. The final shape of such a regime would be strongly dependent on rates and thresholds.

We understand the Review has commissioned research into a number of these ideas and the BCTR looks forward in due course to seeing the results of that research. Depending on the findings that emerge we may well have further discussions with the Review about the best way forward.

The future of dividend imputation

This issue is closely linked to whatever recommendations are made and adopted in relation to the taxation of entities, and the position of the BCTR will to a degree be dependent on what might emerge in respect of that issue.

Unless there is to be a radical reform in the taxation of entities, however, the BCTR sees no basis for changing its previous view that the dividend imputation system should be broadly retained in its current form. The fact that imputation is well understood and favourably regarded by many investors may not be enough in itself to warrant its retention. However, there are many other positives associated with the system, not least the voluntary enhancement of Australian tax payments by listed multi-national groups seeking to maximise franking credits. Thus far, we do not consider the case for moving away from imputation has been made.

It goes without saying that it would be a retrograde step to return to the classical system of the double taxation of corporate earnings, and we would expect an alternative form of taxation relief in respect of dividends to be developed if the imputation system were to be replaced by some other regime.

Tackling complexity

We reiterate the need to seize the opportunity to make some break-through changes that will significantly reduce the complexity of Australia's business tax system. The BCTR's earlier submission pointed to FBT simplification and the optional use of audited financial accounts as two issues having the scope for achieving such break-throughs, but there may be others.

The key to achieving meaningful reduction in unnecessary complexity is to strike the right balance between revenue integrity and compliance costs. Many of Australia's tax laws were developed at a time when that balance was unduly skewed towards integrity. The Board of Taxation's recommendations in respect of the anti-deferral rules are a good example of how that balance can be better calibrated without compromising integrity.

Interest withholding tax

We note and commend the progress that is being made gradually in reducing withholding taxes facing Australian business through the tax treaty renegotiation process. Withholding taxes generally represent a cost to business that is passed onto consumers where possible and reduces Australia's competitiveness.

One area where we consider changes need to be made unilaterally (i.e. ahead of any treaty renegotiations) lies in the interest withholding tax (IWT) area. Without advocating the total abolition of interest withholding taxes, the BCTR considers the global financial crisis has identified a major pressure point in relation to IWT imposed on non-resident funding by financial intermediaries, including related parties. While interest rates are very low historically, financial intermediaries operate on a small margin and IWT can have a major impact on that margin. The BCTR supports the more detailed submission we understand the Australian Financial Markets Association will be making on this matter to the Review.

While this matter has also been raised with the government in a Budget context it is an issue the Review should give priority to if it is not addressed in the near term.

Capital gains tax discount

We disagree with submissions calling for the abolition of the 50 per cent CGT discount for individual taxpayers. Those advocating this change overlook the fact that indexation was withdrawn as at least a partial *quid pro quo* for this concession. Moreover, its withdrawal now would run counter to the global trend to tax mobile capital and business income at lower rates than the top personal rate.

While other stakeholders have called for a tiered system which reduces the taxed amount the longer the asset is held, we believe the current twelve months rule is an appropriate dividing line between speculation and more genuine investments.

ATO governance

Given the speech made by Dr Henry at the recent National Convention of the Taxation Institute of Australia we feel it is incumbent on the BCTR to offer some additional comments on this subject.

The Review needs to recognise that our concerns, and those of a number of other organisations, reflect more than simply some disgruntled taxpayers who were unhappy with the outcome of a particular dispute or ruling request. They represent the considered views of experienced tax professionals and business people with a good deal of experience in dealing with the Tax Office over many years.

What we believe we are seeing is an ATO which is at times inclined to adopt technical positions which would result in greater revenue collection if upheld, which often surprise tax practitioners in the sense that they had thought the law was settled, and which are regarded by many as being inconsistent with policy.

The BCTR has suggested that an oversight board might be helpful in modifying ATO culture, so that ATO officers can be more attuned to business needs and policy considerations. We note Dr Henry's comments about the critical role that corporate boards have in appointing the organisations CEO. However, we would not be particularly concerned if an ATO oversight board lacked this power – provided it was able to impart some business perspective into the way the organisation undertakes its essential role.

Beyond a board, the BCTR believes that active steps need to be taken to bring in suitably experienced persons to fill roles at Commissioner and Second Commissioner level. In our view, such appointments would bring in a much needed fresh perspective to the organisation. Business has a role to play here as Australia lacks the US tradition of senior business people performing key government roles as a "service" obligation.

Since making our previous submission to the Review the ATO has signaled at least one new major "U-turn" in respect of debt deductions relating to funding foreign subsidiaries. Without canvassing the details of the issue here, suffice to say the pro revenue technical view of the ATO comes as a considerable surprise to most practitioners and in their view runs counter to the policy objectives underlying the introduction of the thin capitalisation rules and related legislation in 2001. Such a major surprise coming such a long time into a specific measure is untenable under self-assessment and continues to erode what confidence business has in the ATO to have due regard to policy when interpreting the law.

We would be happy to provide further details on this issue if required by the Review.

Appendix B**Business Coalition for Tax Reform members**

Australian Financial Markets Association

Australian Industry Group

Australian Institute of Company Directors

Business Council of Australia

Corporate Tax Association of Australia

Council of Small Business Organisations of Australia

CPA Australia

Group of 100

Institute of Chartered Accountants in Australia

Insurance Council of Australia

Investment and Financial Services Association Ltd

Minerals Council of Australia

National Institute of Accountants

Property Council of Australia

Real Estate Institute of Australia