

**Business
Coalition for
Tax
Reform**

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SUBMISSION TO THE 2008 FEDERAL BUDGET PROCESS

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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 provide a unified 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.

The members of the BCTR believe that Australia should continuously aim for an optimal tax system, and to that end the BCTR promotes ten principles for Australia's taxation system. These principles are set out in Appendix A.

The BCTR believes that if we are to meet the objectives outlined above, Australia cannot afford to rest here, but must continuously strive for improvement.

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, the tax system must be capable of meeting not only the challenges of today but those likely to arise in the future.

The BCTR also maintains an active interest in the implementation of the Government's tax reforms and endeavours to both promote understanding of the reasons for reform, and provide input into the implementation process.

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

Recent achievements

The BCTR acknowledges the business tax reform achievements of the Commonwealth Government to date.

Most recently, these include:

- the implementation of the business consolidation regime and the associated demerger provisions, which have facilitated business restructuring within wholly owned groups without compromising the integrity of the tax base;
- reforms to Australia's international tax rules which have removed many of the tax disadvantages attached to investing into and out of Australia; and

- the 2006-07 Budget increased the diminishing value depreciation rate for new plant and equipment from 150 per cent to 200 per cent that will apply to all businesses, including those in the minerals exploration sector.

In addition, the BCTR has welcomed recent moves to make Australia's personal tax system more competitive, in particular:

- last year's decision to remove the tax on superannuation end benefits and dramatically simplify the administrative burden on superannuation, which has improved incentives to save; and
- last year's changes to personal tax rates and thresholds, which have improved the ability of Australian businesses to attract and retain highly skilled, internationally mobile workers.

However, the BCTR notes that other countries, including many of Australia's key competitors, are continually fine-tuning their business and personal tax rules, which means the international tax landscape is continuously evolving.

This means in turn that Australia must be prepared to continually review its own taxation arrangements, in order to avoid losing ground. With this international context in mind the BCTR makes the following budget submission.

BUSINESS TAXATION

Tax policy development

The BCTR acknowledges the Federal Government's role in determining the policy settings for Australia's taxation system. However, notwithstanding recent improvements by the Treasury in its consultation process around new tax measures, the BCTR has some concerns about the way tax policy settings are further developed, following their announcement by government.

The BCTR believes that new taxation policy could often benefit from earlier consultation at the level of detailed policy formulation, before the laws progress to the drafting stage. This would enable a more careful consideration of the practical implications of tax policy proposals, and could result in simpler and more effectively targeted measures. In several recent cases, such as the loss usage rules for companies and the promoter penalty regime, policy settings that were inadequately fleshed out before the drafting stage resulted in laws that were too far-reaching and gave poor effect to the stated policy intent.

Improving the consultation at the detailed policy formulation level would, in the BCTR's view, greatly reduce the subsequent consultation times on the draft legislation, once it is completed. It would also contribute to developing legislation that is simple, clear, more certain and easier to comply with. As is currently the case, consultation on detailed policy development may need to take place on a confidential basis with appropriate external stakeholders, relevant to the measures under consideration.

An additional aspect of tax policy consultation relates to the revenue impact of proposed tax measures. The BCTR is concerned that at times it has been difficult for externals to engage on aspects of tax policy proposals because Treasury has felt constrained about disclosing its methodology and assumptions.

The BCTR acknowledges that second or subsequent round effects of tax policy proposals may not be sufficiently precise to warrant inclusion in the Federal Budget's forward estimates. However, they will often be an important driver behind tax policy decision making. As a result, the BCTR believes they should be explicitly factored into the consultation process and any materials published in relation to tax Bills. The BCTR believes that greater transparency around revenue estimates can only assist in the consultation process.

Recommendation 1

Improved and earlier consultation should take place around detailed tax policy development, before legislation progresses to the drafting stage.

The potential revenue impact of proposed taxation measures should be disclosed in a more transparent and consistent way, to enable fuller and more effective consultation.

Tax law simplification aimed at increasing certainty and reducing the cost of compliance

A taxation system should be simple, transparent, and minimise uncertainty. Complexity in the tax law creates uncertainty for business and imposes compliance costs, and reducing complexity should be a guiding principle of tax law development and administration. The BCTR acknowledges the Federal Government's initiative in the recent Board of Taxation project to remove the inoperative provisions from the tax law. However, the BCTR considers that the more significant and critically important challenge lies in reducing the complexity and uncertainty in the remaining operative provisions, as well as the new law that is created every year.

The BCTR is encouraged by the recent announcement that the Board of Taxation is to conduct a review of Australia's anti-tax-deferral rules for foreign income, with the aim of collapsing a number of different regimes into a single set of rules. We believe there are other existing areas of the tax which would benefit from such an examination, such as some of Australia's overly complex trust provisions.

Finally, we note that policy initiatives that require legislative amendment often take too long to be implemented after announcement, sometimes leaving both the ATO and taxpayers in limbo. For instance, a Ministerial announcement of a law change may be made (that may apply from the date of announcement), but it may take years for the law to be drafted and introduced into Parliament. Allied to this, minor technical issues may be left unattended for long periods to make way for higher priority issues. This delay in addressing accepted problems leads to greater uncertainty and increases tax compliance costs.

Recommendation 2

Further work should be done to reduce the level of unnecessary complexity in Australia's tax laws.

Recommendation 3

The Government should provide adequate drafting and other resources to the policy development and implementation process

Addressing the bias against taxed foreign income

The BCTR supports the retention of the dividend imputation system in its current form, but it remains concerned that the double taxation of dividends paid out of taxed foreign earnings creates a bias against Australian-based multi-nationals. In a global marketplace, where most large and an increasing number of small listed companies operate offshore, this situation is unsustainable.

Although the precise impact of the current system on the cost of capital for such companies is difficult to demonstrate empirically, the unfairness of imposing a very high effective tax rate on their domestic shareholders is beyond dispute. Other countries have moved in various ways to reduce taxes on dividends generally, and Australia cannot afford to fall too far behind.

Recommendation 4

The Federal Government should reconsider the Board of Taxation's 2003 recommendation of a 20 per cent partial imputation credit in respect of taxed foreign earnings. The question of streaming foreign income to foreign shareholders should also be reconsidered.

Amortisation of intangible assets

Australia's tax treatment of most acquired intangible assets is less favorable than that of a number of major competitor countries, including the United States and the United Kingdom. This can distort investment decisions by placing Australian-based companies at a relative disadvantage when making strategic acquisitions, as well as inhibiting investment in business processes.

Recommendation 5

Tax relief should be made available in respect of acquired intangible assets. A 15-year tax amortisation regime, applicable to future acquisitions from date of announcement, would place Australia into a competitive position on this issue.

Tax losses and bad debt deductions

The BCTR supports recent moves to streamline and simplify the tax loss provisions. In particular, the BCTR notes that the improvements made to the operation of the Continuity of Ownership Test (COT) in 2005 addressed a number of concerns about compliance costs and uncertainty. These changes have produced a more workable COT test without impacting significantly on revenue.

However, the BCTR believes the introduction of the \$100 million Same Business Test cap, places unfair and unwarranted restrictions on the ability of corporate groups to recoup legitimate commercial losses or bad debts incurred in prior years. The Federal Government announced last year that the SBT cap is to be reviewed. The BCTR believes the cap should be removed and, further, that the operation of the Same Business Test should be modified to reflect the consolidation regime, which already includes a very effective way of countering trafficking in losses or bad debts.

Finally, the Federal Government should give consideration to introducing limited loss carry back rules, which a number of competitor countries have had for a number of years. Loss carry backs give companies that have previously been profitable some opportunity to utilise subsequent losses which might otherwise be "stranded."

Recommendation 6

The loss usage rules should be improved by:

- ***removing the Same Business Test cap and improving its operation by reflecting the provisions of the consolidations regime; and***
- ***introducing limited loss carry back rules.***

Research and Development (R&D)

Discussions with some BCTR members suggest the 175% premium R&D concession may not be as effective in driving business behaviour as was initially hoped. The BCTR believes that, while the idea of encouraging incremental R&D activities is attractive, the current premium regime does little or nothing to encourage companies to consistently maintain a high level of R&D expenditure.

Further, the integrity rules designed to prevent inappropriate manipulation of the concession at times produce arbitrary and unexpected outcomes which the BCTR believes are inconsistent with the policy objective.

Recommendation 7

The BCTR recommends the Federal Government review the premium R&D arrangements with the view of determining:

- ***whether they are achieving their intended objectives; and***
- ***whether there is scope for further improving the regime to encourage sustained higher levels of R&D activity.***

Effective life caps

The BCTR acknowledges changes announced in the 2005 Federal Budget to double the diminishing value uplift for depreciation from 150% to 200%. However, although this represented a welcome across the board improvement to Australia's capital allowance regime, Australia's capital tax depreciation rules for long-life assets remains unattractive compared to many competitor countries.

Under our historical cost depreciation rules, the real value of depreciation deductions for long-life assets is significantly eroded during the later years of the lives of those assets. The situation has been further complicated in recent years through the ad hoc introduction of effective life caps for some industries but not others.

The time is right for a more comprehensive way of addressing the problems confronting industries investing in long-life assets by introducing a 20-year effective life cap across the board.

Recommendation 8

The BCTR recommends there be a 20-year effective life cap on depreciating assets other than buildings.

Corporate tax rate

Although Australia's headline corporate tax rate is broadly comparable to the tax rate of key competitors, the Warburton/Hendy *International Review of Australia's Taxes* released in April notes that Australia has the highest corporate tax burden in the OECD-10 grouping of countries (chosen by the Review panel as those most appropriately comparable to Australia).

This has been underscored by the most recent OECD statistics, which show Australia's corporate tax burden is continuing to increase. The BCTR believes the principal reason for this outcome is the significant strengthening of Australia's business tax base as part of the Review of Business Taxation measures introduced from 1999 onwards.

A recent report by the Committee for Economic Development of Australia, *Tax Cuts to Compete*, suggests that company tax is more responsive than most other taxes in terms of attracting additional foreign direct investment and encouraging economic growth. Combined with the current inflation/interest rate environment, the macro-economic context of the 2007-08 Budget may be such that large personal income tax cuts are not economically desirable. The BCTR believes measures should be taken to reduce the corporate tax burden.

Recommendation 9

The BCTR believes the corporate income tax burden should be reduced through either:

- ***modifying the base by adopting the business taxation recommendations outlined in this submission; or***
- ***reducing the corporate tax rate.***

Child care

Eligibility rules for FBT exemption in respect of employer provided child care currently discriminate between employees on the arbitrary basis of whether the employer is willing and able to provide on-premises child care.

The BCTR believes this discourages many businesses from offering employer-based childcare options, with flow-on effects for the welfare-to-work issue.

Recommendation 10

The BCTR believes that employer-sponsored childcare should be made more viable by removing the on-premises requirement for employer-sponsored childcare.

Further, consideration should be given to extending the FBT exemption to include expense payment fringe benefits.

Withholding tax on distributions from non-residents from Australian Retail Investment Trusts

Australia's competitiveness as a financial centre is under question following the announcement of the proposed 30% withholding rate on distributions to non-resident investors. Australian Retail Investment Trusts ("A-REITs") are particularly affected, as our major competitor markets, such as the United Kingdom, are introducing vehicles which will compete with A-REITs. A-REITs comprise approximately 73% of the listed managed investment market, and are recognised as a world class, sizeable investment which competes on the world stage. Furthermore, our nearest competitors have far more competitive rates of withholding: Japan has a REIT withholding tax rate of 7% (and 0% for super funds), Singapore imposes 0% for individuals and 10% for other investors and Hong Kong has an effective rate of 15% on REITs.

Recommendation 11

The BCTR submits that Australia needs a flat and final withholding rate that is both competitive, and removes the need for complex tax administration. Accordingly, we recommend that a flat and final withholding tax of 12.5% be introduced.

PERSONAL TAXATION

Given Australia's strong reliance on the personal taxes as a source of revenue (as recently affirmed in the Federal Government's *International Comparison of Australia's Taxes* report), the BCTR believes further personal tax reform is warranted if we are to develop and maintain a system that is simple, fair, efficient and internationally competitive.

The BCTR anticipates that the Federal Government's 2007 update of the Intergenerational Report will confirm the need for Australia to prepare to meet the fiscal challenges of an ageing population. Accordingly the BCTR believes it is essential to create a balanced tax regime that is structured in such a way as to adequately meet future government spending imperatives that will arise as a result of these changes.

As discussed above, the BCTR welcomes the Federal Government's recent initiatives to reduce personal taxes through a combination of both threshold and rate modifications since the inception of the New Tax System.

It is clear that Effective Marginal Tax Rates ("EMTRs") and the welfare to work transition remain an ongoing challenge. However, if Australia is to develop a personal taxation system that is fair, efficient and simple, they are a challenge that must be met.

The BCTR acknowledges that both the incidence and impact of EMTRs have been reduced over the last few years. Further, the BCTR supports the Federal Government's approach of targeting welfare to those most in need, and acknowledges that in these circumstances EMTRs can never be entirely eliminated.

Notwithstanding this, we encourage the federal Government to continue to seek improvements in EMTRs as an ongoing agenda item.

As noted in the BCTR's *Personal Income Tax Public Discussion Paper*, released in February, there is no automatic solution to problems with Australia's personal tax system. Instead, these issues would be best addressed via thorough debate and a comprehensive public consultation process. To that end, the BCTR called on the Federal Government to establish a thorough and dedicated review process.

In the context of the current inflation/interest rate environment, the Federal Government may wish to consider directing tax reductions towards further savings incentives by expanding on last year's superannuation initiatives. A reduction in the rate of contributions tax would represent an indirect and less inflationary way of providing tax relief across the board.

Recommendation 12

The Federal Government should commission a comprehensive review of Australia's personal taxation system. That review should be conducted by a prominent Australian, and tasked with developing a clearly structured tax reform plan that will take Australia forward. Such a process would need to address not only costs but also the distributional impacts of potential change.

Recommendation 13

Consideration should be given to additional measures that would increase both the capacity of and the incentives for Australians to save including promoting a culture to support sensible life-time saving through improved policies to encourage children to save. Options that could be considered include further changes to the taxation of superannuation arrangements.

STATE TAXATION AND THE INTERGOVERNMENTAL AGREEMENT (IGA)

The BCTR considers reform of inefficient state-based taxes to be a key element in developing an effective and competitive taxation system for Australia. Furthermore, the BCTR believes that the pattern of Federal/State financial relations should be transparent, efficient and sustainable.

With the introduction of the Commonwealth Goods and Services Tax (GST) in 2000, the Treasurers of each state and territory agreed to abolish nine state-based taxes in exchange for additional GST revenue under the IGA.

The BCTR acknowledges the important reform role the Federal Government has played in this regard, particularly in respect of its offer in March this year to extend the period under which it guarantees no state or territory will be disadvantaged under the IGA to 30 June 2009.

Although all states and territories have now agreed to the revised timetable to reduce many of the taxes cited in the IGA, the BCTR notes that:

- the state and territory timetables for complete abolition of some of these taxes stretch into 2011; and
- no state or territory has timetabled the abolition of non-residential conveyancing duty proposed in the IGA.

The BCTR is encouraged by Federal Treasurer's confirmation that stamp duty on commercial conveyances should remain a part of the reform program.

However, there is concern that without continued pressure from the Federal Government, the state and territory governments will balk at meeting their full IGA commitments and therefore the agreed objectives of the IGA.

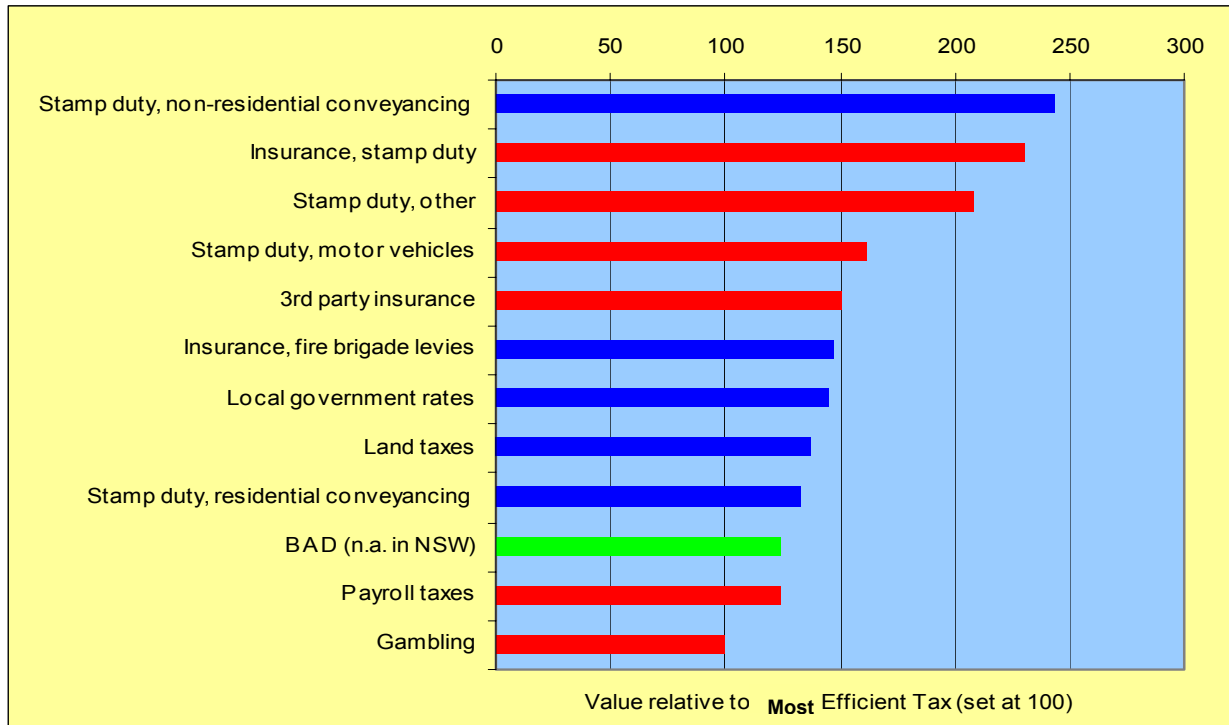
Similarly, without pressure from the Federal Government, the state and territory governments will be reluctant to bring forward the timetabled abolition of the IGA taxes, even as GST windfalls increase.

These delays are a source of considerable frustration for Australian businesses, particularly those operating in more than one state or territory.

It is clear that state and territory governments stand to gain from reducing and abolishing inefficient taxes. The BCTR's 2004 report, *Axing the Alcabala: A program for 21st Century State Tax System* prepared by Access Economics, shows that state and territory economies stand to gain major dividends from meeting the IGA commitments.

These dividends include higher real investment, increased employment and production, and higher real incomes and living standards. This in turn creates a more competitive business environment that attracts increased capital, greater business activity and more jobs.

The report also lists a number of other inefficient state taxes which will give similar advantages to state and territory governments that embrace ongoing reform beyond the scope of the IGA. These include land taxes, local government rates, stamp duty on residential conveyancing, stamp duty on insurance contracts (including life insurance and life insurance riders) and fire services levies. An updated Access Economics table of inefficient state and territory taxes is included below.

(In)Efficiency Ranking for State Taxes

The BCTR urges the Australian Government to continue to encourage the states and territories to embrace an ongoing program of reform in line with increasing GST revenue flows.

Recommendation 14

The Federal Government should continue to exert pressure on the states to:

- **honour the original IGA and abolish all agreed taxes including non-residential conveyancing duty; and**
- **bring forward the timetabled dates for abolition of each IGA tax in line with increasing GST revenue flows.**

Recommendation 15

The Federal Government should seek a commitment from the states and territories to establish a program of continuing reform designed to eliminate all inefficient taxes within the bounds of fiscal responsibility.

APPENDIX A

BCTR Tax Principles

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.

APPENDIX B**BCTR Members**

Australian Financial Markets Association

Australian Institute of Company Directors

Business Council of Australia

Corporate Tax Association of Australia

CPA Australia

Council of Small Business Organisations of Australia

Institute of Chartered Accountants

Insurance Council of Australia

Investment and Financial Services Association

Minerals Council of Australia

Property Council of Australia

Real Estate Institute of Australia