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2 June 2015

Tax White Paper Task Force
The Treasury
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Dear Sir/Madam

"Re:think"

The Group of 100 (G100) is an organization of chief financial officers from Australia's largest business enterprises with the purpose of advancing Australia's financial competitiveness. We welcome the debate on tax reform and the future of the tax system and are pleased to provide comment on the "Re:think" Tax discussion paper.

The G100 strongly believes that tax reform needs to be viewed in a ten-year time horizon which is removed from short-term political expediency and opportunism. As such, it is imperative that tax reform has bipartisan support and acknowledgment of the disruptive and global economic forces driving the need for tax reform and their communication to the Australian public in a language they understand. Accordingly, there must be bipartisan acceptance of the principles upon which robust and sustainable reform is based including agreement on the goals of effective tax reform and the "price" of effective reform. Without such bipartisan agreement in the political process there is a severe risk that genuine reform will be sacrificed for short-term political advantage.

It is essential that all parts of society need to find their voice in the tax reform debate because the underlying objective is the future health of the Australian economy. In engaging in this debate it is important that nothing is "off the table" and to recognise that there is no one panacea. Additionally, we must acknowledge that we may all need to give something up for the greater good of society while ensuring that the less fortunate are protected. If we are to achieve genuine and lasting reform supported by all sections of society partisan politics must be left at the door.

Our responses to the key questions, from a business perspective, are set out below.

Q1.*Can we address the challenges that our tax system faces by refining our current tax system? Alternatively, is more fundamental change required, and what might this look like?*

The G100 believes that significant refinement of the current system is needed with the focus being on reducing the reliance on inefficient taxes such as personal income tax and company taxation and placing greater reliance on consumption taxes while removing distortions and impediments to growth and productivity in the wide range of taxes. We believe that shifting the balance of taxes must be accompanied by a review of the systems of government transfer payments with appropriate compensation mechanisms to protect those most adversely affected. It is also important that the States are fully engaged in the reform process as many of their taxes are inefficient with differences between the States adding to the compliance burden.

The G100 also considers that significant improvements in the way taxpayers interact with the Australian tax system could be achieved by a bold and ambitious review of the current Income Tax Assessment Act (ITAA). The ITAA now runs to several thousand pages and has been described by one senior Federal Court judge as a "parallel universe". A bold and ambitious review of the ITAA should be carried out using the following terms of reference as an example:

- **For each tax rule, are all the pages of legislation really necessary? Can it be redrafted to be simpler, especially for the 95% of compliant taxpayers?**
- **Are all record keeping obligations necessary?**
- **Does each tax rule provide sufficient certainty for taxpayers, advisors and administrators?**
- **Is the particular tax rule in question still a net positive for Australia after comparing "the burden of compliance/disruption to business" with the "tax collections received"?**

Q2. *How well does Australia's utilisation of its available taxes align with the evolving structure of Australia's economy and changes in the international economy?*

The current burden of taxes is an impediment to increasing participation, productivity and economic growth where there is intense international competitiveness for capital and highly skilled labour and disadvantages Australia in attracting overseas investment. However, the imputation system has served, and continues to serve Australia well both in encouraging domestic share ownership in Australian companies and reinvestment of corporate profits in domestic businesses. It should not be forgotten in the discussion of the marginal investor and the marginal source of investment capital that many Australian companies continue to be an attractive investment destination for Australia's growing pool of retirement savings, for example, superannuation funds with an Australian equities component and/or whose mandate is linked to the ASX 100 or ASX 200.

Q3. *How important is it to reform taxes to boost economic growth? What trade-offs need to be considered?*

The G100 believes that a reform of the tax system will be a major contributor to economic growth. The types and rates of tax and the overall taxation regime are important in determining where to invest for providers of capital and where to work in respect of labour resources. Reforming the taxes that bear upon these decisions would boost productivity and investment which are essential to enhanced economic growth.

Currently, Australia does not utilise the available taxes well as the majority of the revenue is raised from the imposition of inefficient taxes such as company and personal taxes and stamp duties, while efficient taxes such as broad-based consumption taxes are underutilised.

Given the constitutional allocation of tax streams to Federal and State governments and the resulting fiscal imbalance the G100 acknowledges that this will require significant and ongoing bipartisan cooperation at all levels of government.

We believe that a reduction in the company tax rate is an important component of the tax reform debate. Given the present budgetary environment we suggest that the announcement of a phased future reduction in the company tax rate would have a favourable impact on business confidence and the willingness to undertake investment.

Q4. *To what extent should reducing complexity be a priority for tax reform?*

The G100 believes that complexity in taxation arrangements leads to a misdirection of resources as taxpayers need to incur significant dead-weight compliance costs. Complexity can also encourage some to seek to minimise their taxes. Reducing complexity and simplifying the taxation regime will contribute towards cost savings and a better allocation of resources. Similar to uncertainty, complexity can serve as a disincentive to offshore investors when comparing investment in Australia with other countries. The fact that $40 billion is incurred by taxpayers and government each year is clear evidence that complexity should be reduced.

Q5. *What parts of the tax system are most important for maintaining fairness in the tax system? Are there areas where fairness in the tax system could be improved?*

The G100 considers that the primary purpose of the tax system should be to raise government revenue in the most efficient and equitable way possible and that redistribution through the tax system should be discouraged. Redistribution should only occur through the transfer system. To this end, the G100 considers that taxation reform cannot be achieved in isolation and must be accompanied by a review of government transfer payments and the social safety net including the welfare system to ensure that there is well targeted, durable support for the less well-off.

Q6. *What should our individuals income tax system look like and why?*

It is important that the personal income tax system does not penalise workers or discourage them from earning higher incomes as commonly occurs with bracket creep. The personal income tax system should also encourage workforce participation as the current system is a major impediment for many potential workforce participants such as internationally mobile workers and part –time workers.

A personal income tax system should be founded on the following principles:

- **an aspiration to reduce personal income tax rates and reduce bracket creep , for example by indexing marginal tax brackets, so as to encourage increased workforce participation;**

- **creating greater alignment between the tax rate thresholds and transfer payment rules so as to avoid the "double whammy" of higher tax thresholds and loss of benefits which is a significant discouragement to participation;**

- **reducing the churn of tax and transfer systems such as taxing low and medium income earners who then receive benefits under the transfer system; and**

- **parity of taxes between entity types in order to discourage taxpayers from using trusts and other structures to shift income to lower taxed structures.**

Q7 *What should our fringe benefits tax system look like and why?*

The G100 believes that the FBT regime:

- **imposes significant compliance cost on employers while achieving relatively modest tax collections. The cost and effort of complying with the FBT provisions is disproportionate (relative to other taxes) to the amount of revenue raised; and**

- **should be remodelled along the lines suggested in the Henry Tax Review so as to include benefits in the employee's assessable income rather than being taxed to the employer.**

Australia should follow most other countries and change the FBT system so that fringe benefits are taxed to employees (only Australia and New Zealand tax fringe benefits at the employer level). There is no reason why the tax on non-cash benefits should be assessed to the employer while the tax on cash benefits is assessed to the employee.

Q11. *How important is tax as a factor influencing people's decisions to work in other countries?*

See Question 6. This is particularly important for a small but significant sector of the workforce.

Q16. *To what extent does our fringe benefits tax system strike the right balance between simplicity and fairness? What could be done to improve this?*

See Question 7.

The FBT system should be efficient, equitable and simple to comply with. Since the introduction of FBT in 1986, compliance with the FBT system has become progressively more complex.

The FBT exemptions and concessions should be "modernised" and simplified in any review of FBT. That is, each exemption and concession should be reviewed to determine whether it is still appropriate in today's society. For example:

- **FBT arguably has the greatest compliance cost of any tax and places a significant compliance burden on all employers (from large corporates to not-for-profits);**

- **the FBT rules are complex, highly prescriptive and inflexible. Any concessions provided are too low (in dollar terms); and**

- **a proposal to provide a more equitable solution is to shift the FBT impost from employers to employees. There is no reason why the tax on non-cash benefits should be assessed to the employer while the tax on cash benefits is assessed to the employee. Taxing fringe benefits at the employee level has the potential to deliver greater neutrality in the treatment of cash and non-cash remuneration.**

Q17. *To what extent are the concessions and exemptions in the fringe benefits tax system appropriate?*

See Question 7. The FBT exemptions and concessions should be "modernised" and simplified in any review of FBT. That is, each exemption and concession should be reviewed to determine whether it is still appropriate in today's society and onerous compliance costs reduced through greater simplification. For example:

- **the minor benefits exemption limit of $300 is too low from a compliance perspective and should be significantly increased. Any limit should be indexed each year or alternatively reviewed every few years for appropriateness; and**

- **the minor benefits exemption should be extended to include in-house benefits.**

The G100 believes that if the present requirements are retained the reportable fringe benefit threshold should be increased and indexed annually (or at least regularly reviewed).

Q18. *What tax arrangements should apply to bank accounts and debt instruments held by individuals?*

Ideally, investors should not be motivated by tax biases across different forms of savings. At present, interest earned on bank accounts and other debt instruments by individuals are treated less favourably under the tax system than other investments. An investor should be making an investment decision based on the instrument's risk/reward profile, the time value of money etc rather than the way in which that income is taxed. The nature of the investment, whether debt or equity, should be tax neutral in terms of outcomes for the investor.

Q19. *To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?*

The differential tax treatment of capital and revenue allows for the effect of inflation. The CGT discount is appropriate in order to ensure a dynamic movement of capital across the economy and to avoid the "lock-in" effect which occurs when holders of capital are discouraged from disposing of capital because of high tax rates on capital gains which results in a less efficient allocation of capital which impairs productivity and growth.

The G100 believes that there is a strong case for simplifying the taxation of capital gains through adopting a broad-based low rate system with few concessions where only concessions with clear policy objectives are retained.

Q20. *To what extent does the dividend imputation system impact savings decisions?*

The dividend imputation system impacts savings decisions at the margin. The removal of dividend imputation would result in the reintroduction of double taxation on domestic corporate profit distributions and would have a negative effect on Australian domestic investors and equity markets and impact the savings of households including their superannuation funds. In a low interest rate environment investors are seeking higher yield investments and as a result are accepting more equity risk in return for an increased yield when compared with a higher interest rate environment where investors look to balance risk, capital growth and income. See Question 25.

Q24. *How important is Australia's corporate tax rate in attracting foreign investment? How should Australia respond to the global trend of reduced corporate tax rates?*

The G100 considers that the corporate tax rate is an important factor considered by foreign investors and as such a lower rate is likely to be beneficial. However, the headline rate is only one factor to consider as the tax base is also significant to the extent that there are special allowances for certain types of activity and what is allowed as a deduction, for example whether accelerated depreciation and amortisation of intangible assets is permitted. It is also important that in having settings which are attractive to foreign investors the large and growing pool of domestic investors is not disadvantaged. For example, the imputation system has been beneficial in encouraging domestic investment in entities paying Australian tax.

If we are to change rates to be more competitive it is necessary to determine who we are competing with and the type of investment we are seeking to attract. For example in the Asia Pacific region the corporate tax rate varies from 33% in Pakistan to 16.5% in Hong Kong with significant differences in other countries. In Europe, corporate tax rates vary from 20% in the United Kingdom to 33.99% in Belgium.

Q25. *Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?*

Dividend imputation is an important feature of the tax system and equity markets for domestic investors. The benefits of dividend imputation include the elimination of double taxation of domestic company profits which was the fundamental principle underlying imputation, reducing the bias for debt over equity, reducing the incentives for Australian companies to reduce their tax and results in higher rates of return for Australian investors.

Australian investors seek both revenue and capital growth and will accept lower revenue (dividends) where there is the prospect of growth in future dividends (or unfranked dividends where earnings are offshore).

An imputation system that encourages companies to effectively distribute as dividends profits that have already been taxed has the benefit that Australian domestic shareholders are supportive of companies paying Australian tax. This has the associated benefit of encouraging higher payout ratios, for example, compared with other countries such as the USA, and has meant that the parking of profits in lowly taxed offshore jurisdictions is not a major feature of the Australian tax system.

In the case of dividends paid to offshore shareholders, franking credits are in effect retained by the ATO which is revenue positive. Likewise, franked dividends paid to shareholders whose marginal tax rate is greater than the corporate tax rate results in further tax collections with the result that the corporate distribution is effectively taxed at the shareholder's marginal tax rate.

The imputation arrangements could be improved by removing potential distortions and impediments to Australian companies seeking growth offshore. For example, as Australian companies expand further into the global economy an increasing proportion of their profit will be earned and taxed offshore. When these profits are ultimately distributed to Australian resident shareholders there will be a significantly increased amount of tax to be paid. For example, an Australian company earning $100 in Australia and paying $30 of Australian tax will have $70 to distribute to shareholders. If the shareholders are Australian resident at the highest marginal rate (49%), they will pay $19 of additional tax after franking credits. If instead the Australian company earned $100 and paid $30 of tax outside Australia, the same $70 dividend would bear an additional $34.30 in tax. A similar tax disadvantage occurs for Australian taxpayers at all tax rates. If the dividend was paid to non-resident shareholders they would typically receive (before the deduction of any tax in their own jurisdiction) between $59.50 and $70 after any Australian dividend withholding tax is deducted.

This situation is worse where an investment vehicle is outside the tax consolidated group. For example, consider an Australian tax consolidated group that provides seed funding and takes an equity stake in a start-up company. If that start-up is successful and established an offshore presence that derives $100 in foreign income that is taxed at 30%, it will be able to distribute $70 to its Australian parent. The Australian parent will pay no further tax because dividends from foreign subsidiaries are treated as exempt, but as it sits outside a tax consolidated group, when it pays the $70 to its immediate shareholders, they will be subject to additional 30% company tax, leaving $49 which can be distributed to their individual shareholders fully franked. Top up tax of $13.30 would be payable by an individual shareholder on the top marginal tax rate of 49%, giving total tax paid of $64.30, consistent with the example above. However, in this situation there is an additional leakage of $21 at a company level. This would disadvantage companies that, for example, are unwilling or unable to pay dividends to their shareholders. If Australia were to remove dividend imputation, the $49 would be taxed in the hands of ultimate shareholders at say, the top tax rate of 49%, leaving them with only $25 as opposed to $35.70 in the example above.

Countries such as the US, UK, Germany, China, Canada, Japan tax their resident shareholders at the same rate (usually lower than the marginal tax rate) regardless of where the profits are earned.
Failing to address the tax disincentive for Australia resident shareholders to invest in Australian based multinational companies' risks making these

companies or their offshore assets more valuable in the hands of non-resident shareholders which do not face the same disadvantage. Australian investors' portfolios will be biased towards domestic portfolios reducing risk-adjusted returns. Small and medium sized companies, that do not access international capital markets, will face higher equity funding costs for foreign expansion.

In summary:

- **The dividend imputation system continues to serve as an appropriate methodology for avoiding the double taxation of corporate profits (at the corporate level and shareholder level).**

- **The dividend imputation system also, inadvertently, serves as an integrity measure. Shareholders appreciate/demand fully franked dividends. Dividends can only be fully franked if the company pays sufficient Australian taxes.**

Overall, we believe there is scope for refinement to increase Australia's competitiveness in capital markets and to remove potential distortions and impediments to Australian companies seeking growth offshore, whilst not impairing domestic investment.

Q26. *To what extent would Australia benefit from the mutual recognition of imputation credits between Australia and New Zealand?*

The G100 understands that mutual recognition of imputation credits between Australia and New Zealand would be beneficial to both the Australian and New Zealand economies. At present Australian companies that pay New Zealand tax can distribute franking credits to New Zealand shareholders. However, there is a significant wastage as credits are required to be attached to all shareholders on a pro-rata basis.

Q27. *To what extent does the tax treatment of capital assets affect the level or composition of investment? Would alternative approaches be preferable and, if so, why?*

Capital assets should be taxed at a lower rate to encourage capital investment and reduce the cost of capital. The G100 recommends that the concessions available to other entity structures and small business be extended to be available for companies by removing the revenue/capital distinction as discussed in Question 36.

The following factors are relevant to this discussion:

- **The tax treatment (in Australia and relative to the rest of the world) of capital assets influences investment decisions in Australia.**

- **Investment decisions in Australia would be influenced by capital allowance incentives such as accelerated depreciation, tax cost base loading and an investment allowance.**

- **Given the modern digital economy, there is no logical reason why the Uniform Capital Allowance (UCA) regime should provide a comprehensive generic write-off regime for wasting tangible assets but only provide a limited write-off regime for very specific and limited intangible assets. This is not only inequitable; it is non-commercial as it artificially skews investment decisions towards tangible assets. The time is right for the UCA to provide a generic write-off regime for all wasting assets, whether tangible or intangible.**

- **The depreciation methodology should be more flexible and allow a hybrid Straight Line Method / Diminishing Value Method depreciation model (as per the USA).**

Q28. *How complex is the tax treatment of capital assets and are the costs of compliance significant?*

The main compliance cost and complexity arises from the need to keep records of multiple effective lives for different assets. This is exacerbated by differences between tax and accounting record keeping. Alternatively, average rate pools like the low value pools could be considered. Greater efficiencies would be obtained by aligning tax depreciation rates and accounting depreciation rates. The complexity in navigating between self-assessed useful lives and the tax safe harbour rates consumes significant resources.

The regime could be simplified by having a fixed depreciation rate for all assets or average rate pools like the low value pool. However, this would be a significant change and the same asset may have different effective lives depending on the industry. In addition, small business may be able to benefit from a simplified system where they can have an option to opt in for a uniform depreciation rate for all physical assets and a uniform amortisation rate for all intangible assets.

In this context some level of closer alignment between the accounting depreciation rules and UCA rules would provide significant compliance benefits. Areas where members have found the non-alignment "challenging" include:

- **tax restrictions on when effective lives can be re-assessed, as opposed to the more pragmatic accounting rules;**

- **leasehold improvements, where accounting uses the term of the lease while tax uses either statutory or effective life rates and then makes a reassessment at the end of the lease to determine the write-off for any undeducted balances; and**

- **accounting rules for the immediate expensing of low value assets vs the use of low cost tax pool.**

Q29. *To what extent does the tax treatment of losses discourage risk-taking and innovation and hinder businesses restructuring? Would alternative approaches be preferable and, if so, why?*

The current tax treatment can be an impediment to genuine business restructuring and acquisitions. For example, often start-up companies incur losses that an acquirer or investor cannot use and, as such, would not price in the losses.

The G100 believes that a genuine acquirer should be able to access the losses of a business which would require the relaxation of the current restrictions on the transfer and carry-forward of losses, especially with respect to the Same Business Test (SBT). The measures can include:

- **removing or reducing the current restrictions and inserting anti-avoidance provisions to deal with loss trafficking such as a requirement for a genuine commercial purpose other than accessing losses;**

- **relaxing the requirements for meeting the SBT;**

- **quarantining losses to be offset against income generated from a business of the same kind rather than cancelling the losses;**

- **while we appreciate that the loss utilisation rules were developed to prevent "loss trading" and loss "multiplication" by applying the Continuity of Ownership Test ("COT") and the Same Business Test ("SBT") to carry forward losses, these tests are overly complex;**

- **the application of the SBT in a consolidation environment has become problematic; and**

- **further, the SBT is arguably commercially counter intuitive in that it often does not allow the new owners of a business to "fix" the very problems that caused the loss in the first place.**

***Q30**. How could the current tax treatment of intangible assets be improved?*

The non-deductibility of amortisation expense, such as purchased goodwill, increases a company's effective tax rate which disadvantages those businesses whose activities involve significant intangible assets compared with those companies having "bricks and mortar" business activities.

The cost of intangible assets acquired as part of a third-party transaction is supported by robust valuation processes and should be available as an allowable deduction because the intangible asset is being acquired to generate future income streams. This being so it makes commercial sense to allow the cost to be deducted over the life of the asset in the same way as occurs for physical assets such as plant and equipment.

It is critical that the current rules regarding software be reconsidered. The current rules create a disincentive for software development where the particular software does not qualify for the R&D concession and where the software is licensed to third parties. Where this is the case the relevant developer is not entitled to depreciate software under the 5 year 'in house' regime and must depreciate the software over 25 years.

This is clearly uncompetitive internationally. In economic terms it is ridiculous because, in general, most software is obsolete within 3 years. Such a change is not in the nature of providing special incentives: it is simply a matter of economic rationalism and international competitiveness.

The Australian software write-off regime is uncompetitive by international standards. For example if software is expensed for accounting in the UK, a 100% tax deduction is available in that year.

Q31. *To what extent should the tax system be designed to attract particular forms of inbound investment (for example, by distinguishing between active and passive or portfolio and non-portfolio)? If so, what principles should inform this?*

Investments that are seen as being critical to the development of Australia should not be impeded by the tax system. However, providing concessions to inbound investment only has the potential to disadvantage domestic companies competing in the same markets.

Q32. *To what extent does the tax treatment of foreign income distort investment decisions?*

See Question 25.

There is a bias in favour of equity investment due to the participation exemption (exemption for non-portfolio dividends and capital gains (for active investments)). It is not yet clear whether the changes to the debt/equity rules will remove this bias (that is, loans with equity character will be entitled to the participation exemption?).

Q33. *To what extent should the tax system be designed to encourage particular forms of outbound investment (for example, by distinguishing between active and passive or portfolio and non-portfolio)? If so, what principles should inform this?*

The G100 favours retaining the concession for non-portfolio investments and agrees with the current 10% interest being the basis of distinguishing portfolio and non-portfolio investments.

In our view, a bias in favour of active investments is appropriate as it encourages offshore investment by Australian taxpayers (capital export neutrality). However, we note that the imputation system has the opposite bias as foreign tax does not generate franking credits.

The G100 believes that the Controlled Foreign Company (CFC) rules have been very effective in preventing BEPS style tax avoidance. However, the rules are out-dated and overly complex and need to be modernised and simplified to ensure that Australian outbound companies are not disadvantaged when competing internationally. However, the G100 would also caution against unilateral action and supports Australia's continued participation in the OECD's BEPS work.

Q34. *How can tax avoidance practices such as transfer pricing be addressed without imposing an excessive regulatory burden and discouraging investment?*

The G100 considers that is too soon after the recent reform of transfer pricing rules to determine whether the reforms are adequate and effective. As indicated above, the G100 also cautions against taking unilateral action and supports Australia's continued participation in the OECD's BEPS work.

Q35. *Should the tax system provide a more neutral treatment of different financing arrangements (debt, equity and retained earnings), and if so, how? What principles should inform the approaches?*

As noted above for an Australian domestic investor the current system is neutral between holding a bond or a share. For example, an Australian corporate has $100 EBIT and pays $70 interest to a bondholder. It pays $9 company income tax and distributes the remaining $21 as a franked dividend. If the bondholder and the shareholder are the same person they receive (gross) $70 interest plus $30 dividend ($21 net plus $9 franking credit). If the same company had no debt it would pay $30 tax and have a profit after tax of $70.
If it distributes this the shareholder will receive $100 comprising $70 net plus a franking credit of $30.

However, issues arise as to the treatment of the foreign investor in the two situations.

Q36. *Should the tax system provide a more neutral treatment of income earned on revenue account and capital account? Does the distinction create significant compliance costs for business and, if so, how could it be simplified?*

The distinction between revenue account and capital account relies heavily on the purpose of the taxpayer when entering the investment. However, for both taxation and accounting purposes a distinction is made between the need to fairly classify assets that provide an enduring advantage over their useful lives and those outlays/expenditures that are consumed in the current period.

Q37. *Are there other important issues in the business tax system, not covered in this section, which should be considered as part of the Tax White Paper process?*

The G100 believes that the current process should:

- **focus on reducing the reliance on inefficient taxes such as personal income tax and company taxation and placing greater reliance on consumption taxes while removing distortions and impediments to growth and productivity in the wide range of taxes;**

- **address and resolve issues such as TOFA and tax consolidation for which there are ongoing consultations; and**

- **target the black/cash economy and assess its impacts.**

Q38. *In what circumstances is it appropriate for certain types of businesses to be subject to special provisions? How can special treatment be balanced with the goal of a fair and simple tax system?*

The attempts by government to identify winners are counter–productive. Australian economic history shows that the provision of subsidies and grants will ensure inefficiency, higher cost in the supply chain and higher prices for end consumers. This has the impact of lessening the availability of investment funds for those areas of the economy that are efficient and internationally competitive as well as diverting funds away from infrastructure and precursors to economic efficiency e.g. education, transport, sustainability.

Q39. *Does the R&D tax incentive encourage companies to conduct R&D activities that would otherwise not be conducted in the absence of government support? Would alternative approaches better achieve this objective and, if so, how?*

The G100 understands that its members are not conducting R&D for the sake of the incentive and while the concession is a factor that influences R&D investment decisions it does not necessarily drive those decisions. Underlying these activities is the need for certainty as many R&D projects run over very long time frames.

Both the current and former governments considered that large companies would still undertake R&D regardless of the R&D incentive. We consider this proposition to be flawed and counter-intuitive for the following reasons:

- **R&D is a business cost like any other cost. Increasing the after-tax cost of R&D is likely to discourage investment at the margin. It will also mean that Australia becomes a relatively more expensive place in which to invest in R&D.**
- **Whether or not the R&D incentive encourages large companies to undertake R&D, it certainly encourages them to undertake the R&D activities in Australia (either directly or through contracted R&D with small and medium enterprises). Such activities create jobs in Australia and result in wages and salaries, profits etc which are taxable in Australia.**

The following factors are also relevant in this debate:

- **any removal of the incentive would have negative flow-on effects on the Australian labour force, not just those employed by large companies but also those smaller Australian companies that undertake R&D on behalf of the large companies. This may lead to a 'brain drain' from Australia if it becomes uneconomical to undertake R&D activities domestically;**
- **the R&D tax regime does encourage companies to invest in risky R&D projects in order to generate innovation and competitiveness for Australian companies;**
- **over the last decade, foreign tax jurisdictions have continually increased their R&D incentives in the form of tax concessions/offsets/deductions to attract investment and innovative talent to their country. Countries like Singapore and India provide very generous R&D tax incentives – up to 400% deductions;**

- **with an increasingly mobile global workforce, it is not difficult to relocate and/or undertake R&D work in a country which provides more generous tax incentives to do so. We should encourage innovation to be carried out in Australia;**

- **to encourage companies to pursue more aggressive innovation and to assist smaller-scale entrepreneurship – direct government grants and funding for projects would be more effective. Successful grants would mean that applicants receive the funding upfront rather than claiming tax back after the money is spent; and**

- **recent changes to the R&D incentive limiting the ability to R&D eligible expenditure over $100 million is a concern as this may cause companies to review their strategy for continued growth in investment in this activity in Australia.**

Q40. *What other taxation incentives, including changes to existing measures, are appropriate to encourage investment in innovation and entrepreneurship?*

We believe that an improvement to employee share schemes is appropriate as a means of encouraging entrepreneurship and investment in innovation.

The current R&D exclusion for software developed for use primarily by internal company personnel for business administration functions (even if access to this is licensed to third parties) should be removed. Internal software still provides benefits in the form of increasing the productivity and global competitiveness of the company undertaking the R&D and can have spill over benefits for other businesses and the public.

Q50. *To what extent are the tax settings (that is, the rate, base and administration) for the GST appropriate? What changes, if any, could be made to these settings to make a better tax system to deliver taxes that are lower, simpler, fairer?*

The G100 believes that the current tax settings are inimical to encouraging work force participation and increases in productivity and economic growth and that the focus should be on changing the balance of taxes to foster economic activity.

Q51. *What are the relative priorities for state and local tax reform and why? In considering reform opportunities for particular state taxes, what are the broader considerations that need to be taken into account to balance equity, efficiency and transitional costs?*

The G100 supports a shift in the weighting of taxation away from inefficient direct taxes towards efficient indirect taxes as explained at Question 53.

For example, a consistent payroll tax regime across all States would reduce the level of complexity and compliance costs. Consolidating a company's payroll tax reporting requirements to a single national body would deliver simplicity and efficiency for a business that operates in several States.

Q52. *Does each level of government have access to tax revenue bases to finance new spending decisions? If not, should arrangements change to achieve this? How should they change? How important is it that the national government levies taxes on mobile bases? Could some taxes be shared?*

The G100 believes that any tax imposed should satisfy the principles of equity, efficiency and simplicity. Additionally, there should not be double taxation of the same tax base at the State and Federal level. For example, land tax should not be applied at both levels of government.

Although the Constitution has served Australia well, the way it allocates revenue and expenditure streams between the Federal and State Governments is out-dated. Capital and people are now more mobile than ever and businesses know no boundaries. Addressing the resulting fiscal imbalance (both horizontal and vertical) must be a key consideration in tax reform, and the outcomes must be agreed by all levels of government. Each level of Government will need to focus on what is in the best interests of all Australians, rather than merely their voting constituents.

As explained at Question 51, we would encourage tax collections to become more consolidated across all States and the revenues collected distributed to the States (akin to GST) in a fair and equitable manner which takes account of the ability of each State to raise revenue from other sources.

Q53. *To what extent does Australia have the appropriate mix of taxes on specific goods and services? What changes, if any, could improve this mix?*

The G100 believes that the current mix of taxes in Australia is not appropriate in a growing open economy and strongly supports a shift in the weighting of tax revenues from direct taxes such as personal income taxes and company income taxes towards consumption related taxes which are broadly based and are sufficiently robust and flexible to respond to changes in consumption patterns as is occurring with the growth of the digital economy. The current over-reliance on taxes, profits and income impacts adversely on economic behaviour. For example, bracket creep impacts on employees and workforce participation. Lower levels of direct taxation would mean that employees are better empowered to make their savings/consumption choices.

This shift in the mix of taxes must be accompanied by reviewing the social safety net and providing durable targeted welfare measures.

Q54. *To what extent are the tax settings (i.e. the rates and bases and the administration) for each of these indirect taxes appropriate?*

Narrowing the base of taxes adds complexity, creates greater scope for avoidance, requires more enforcement resources, and reduces collections. Consideration should be given to broadening the base of indirect taxes, offset by reductions in inefficient direct taxes.

A narrow base can also be inefficient and impact the decisions of taxpayers. For example, with the $1,000 GST exemption threshold on imported goods a consumer can purchase goods from an offshore online retailer without incurring GST whereas the price charged by a local Australian retailer includes GST, making it harder for Australian retailers to complete with offshore distributors. It has been argued that this exemption exists as the cost of enforcement and collection outweighs the revenues collected. However, the cost to the local retail economy is ignored in this analysis. Consideration should be given to the removal of this exemption.

Q55. *What changes, if any, could be made to these indirect tax settings to make a better tax system to deliver taxes that are lower, simpler, fairer?*

The G100 believes that more emphasis on efficient indirect taxes including the GST is highly desirable. However, any increase in the rate of taxation and broadening of its scope must be accompanied by reviewing the social safety net and ensuring that those adversely affected are adequately compensated to enable them to meet any increases in the cost of living.

Q56. *What parts of Australia's tax system, and which groups of taxpayers, are most affected by complexity? What are the main causes of complexity?*
The G100 believes that all classes of taxpayers are adversely affected by the current level of complexity in the tax system. The main causes of the complexity are the absence of a holistic approach to taxation and the current piecemeal and patchwork approach to amendments to the tax system including its administration.

Q58. *What system-wide approaches could have the greatest impact on reducing complexity in the tax system? Why have previous attempts to address complexity in the Australian tax system not succeeded? How might it be done in a way that is more successful?*

The G100 recommends the establishment of an Australian Tax Reform Commission, similar to the Productivity Commission, as an independent tax reform and research advisory body to the Government charged with the responsibility to advise on the system-wide approach to improving and simplifying the tax system. Ideally, membership of such a body would comprise respected leaders from business, the profession, welfare bodies and academia.

Q59. *In what ways can reforms of tax administration best assist in reducing the impact of complexity on taxpayers? Are there examples from other countries of tax administration reform to reduce the impact of complexity that Australia should adopt?*

The G100 believes that reducing the number of taxes that apply to businesses would contribute to a reduction in complexity and compliance costs. For example, applying a uniform rate and administration for payroll tax should be negotiated with the States.

Q60. *What processes or systems currently being used by businesses and individuals could the ATO better utilise to lower the compliance costs of the tax system?*

The G100 supports the introduction of cost effective processes and systems that simplify tax administration. The G100 has previously recommended and supported the formation of an advisory board to provide advice to the Commissioner for Taxation on the management and operation of the ATO and its relationships with taxpayers.

Q61. *Could administrative responses — such as embracing technology, harnessing data and taking the whole-of-government approach to administration — help address the issue of tax system complexity?*

Yes.

Q62. *Would there be benefits in integrating the administration of taxes across the Federation? If so, what would be required to realise these benefits?*

Yes, bipartisan support for such integration is required of all levels of government.

Q63. *What changes could be made to provide greater certainty, transparency and accountability to tax policy development in Australia?*

The G100 believes that the responsibilities of the ATO should be limited to the collection of taxes and enforcement of the legislation and consider that the following bodies independent of the ATO should be established:

- **an Australian Tax Reform Commission as an independent tax reform and research and advisory body to the Government which has the legislative power and determines which reforms etc to implement. The Government could provide the Commission with references after the style of references to the Productivity Commission or which occurred in respect of Companies and Securities Advisory Committee;**

- **a body which is responsible for dealing with tax objections and repeal processes; and**

- **a governance body, with independent membership, to oversee the operation of the ATO.**

Q64. *Are current tax review arrangements appropriate? How could they be improved?*

The G100 considers that tax reviews should be more proactive and systematic and be free of political interference in the review process.

An annual tax review bill that would enable incidental, non-controversial, essentially revenue neutral, tax amendments to be made, and otiose or redundant provisions to be removed.

Q65. *Could the arrangements for developing tax policy in Australia be improved? If so, how?*

See Questions 63 and 64.

Q66. *Would the benefits of releasing more tax data and detail around costings outweigh the costs?*

The G100 considers that this would be the case and believes that the disclosure of increased data and details would invite more fulsome discussion on the fiscal impact of tax regimes and reforms.

CONCLUSION

As outlined in our publication *"Let's have a real debate about tax reform to keep Australia strong"* (enclosed), the G100 strongly believes that tax reform needs to be viewed in a ten year time horizon having bipartisan and general community support. This support is essential in order to design efficient and effective Federal and State tax systems which will provide the environment to foster economic growth and increases in living standards.

Yours sincerely
Group of 100 Inc

N Mitchell

Neville Mitchell
President

Enc. G100 publication