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31 January 2023

Dear Sir/Madam,

2023-24 PRE-BUDGET SUBMISSIONS

BDO refers to the invitation by the Assistant Treasurer and Minister for Financial Services on 5 December 2022, to submit ideas and priorities for the 2023-24 Federal Budget and welcome the opportunity to lodge a submission.

BDO takes this opportunity to call on the Government to take heed of the many calls for tax reforms and regulation simplification coming from tax, accounting and legal professions, businesses and industry bodies.

BDO's 2023-24 pre-budget submission, therefore, urges the Government to reinvigorate the tax reform agenda with a focus on how the tax system can be simplified, be more equitable and efficient (acknowledging there are conflicting aspects of these three goals).

Tax reform is not just about tax cuts, it entails a rational identification of how all aspects of the tax system interact with each other and with the economy and to identify how to ensure the appropriate amount of tax is collected from the right entities without causing much distortion to the economy. Our major recommendation is the re-ignition of the tax reform process, not as a one off but rather as an ongoing process, that sees tax reform as a Government priority. The remainder of our recommendations are issues that we recommend be considered as part of the holistic tax reform process.

BDO's recommendations for taxation priorities for the 2023-24 Budget are detailed in the attached Appendix and summarised below.

Category	Recommendation	Page
Tax reform	#1 - The Australian tax reform process needs to be re-ignited with a holistic review of all Federal and State taxes and steps towards establishing an independent Tax Reform Commission that has an ongoing role to develop tax reforms recommendation for the Government.	5
	#2 - Certain changes to income tax laws which have been the subject of prolonged review and discussion should be implemented. These include the Controlled Foreign Company (CFC) rules, review of the taxing of trusts, Division 7A rewrite, Review of small business concessions and Review of CGT rollovers. The review of the CFC provision is particularly important to ensure they are consistent with the Hybrid Mismatch rule and the BEPS Pillar 2 proposal.	5

	The prolonged process of re-enacting the provisions of the *Income Tax Assessment Act 1936* (ITAA 1936) into the *Income Tax Assessment Act 1997* (ITAA 1997) should also be expedited.	
Company Tax	#3 – The corporate tax rate should be reduced to 25% for all corporate tax entities to ensure Australia is competitive in attracting international capital to develop our economy. In addition the current two tier tax rate is causing double taxation as a result of trapped franking credits and administrative complexities for base rate entities and their shareholders..	6
Significant Global Entities (SGEs)	#4 – The Government should consider revisiting the SGE definition to exclude entities with less than $10 million Australian turnover to relieve them of the exorbitant potential penalty rates applicable to SGE's.	7
Dividend Imputation	#5 – The imputation system should be subject to a post implementation review to identify the relative advantages and disadvantages of the imputation system, including its effect on debt and capital markets, and whether it affects companies' decisions to either invest their profits or pay franked dividends, consider alternative corporate tax systems used by other developed economies and the effect on the overall effective corporate tax rate.	7
	#6 - Revise the 45 day holding rule so that it only applies to the specific situations it was meant to stop and is re-written into the ITAA 1997.	8
Superannuation	#7 – The Caps on superannuation contributions should be reviewed to determine the effect of such capping on superannuation income stream adequacy and also consider the replacement of annual contribution caps with a lifetime contribution cap to provide for many workers who can only afford to make additional contributions later in their working life.	9
Trusts	#8 – The rules around taxing trustees and beneficiaries should be reviewed with urgency.	10
	#9 - Section 99B of the ITAA 1936 should be revised so that it only applies to the mischief it was aimed at. For example it currently inappropriately applies when accumulated foreign source income is paid to an Australian resident beneficiary who was a non-resident when the trustee derived the income i.e. when both taxpayer and the income were outside the Australian tax net.	10
	#10 – Section 100A of the ITAA 1936 relating to reimbursement agreements should be clarified and rewritten to provide certainty for taxpayers and advisers. In particular, to clarify the exclusions from a 'reimbursement agreement' for agreements entered into "in the course of ordinary family or commercial dealings". The recent release of TR 2022/4 and PCG 2022/2 does provide some guidance in relation to the ATO's compliance approach and	11

	examples of cases that may fall within specific risk categories. The legislation should be rewritten in order to improve the integrity and effectiveness of these measures.	
Small to medium businesses	#11 – The structures used by SMEs should be reviewed and the establishment of a “small business company” concept introduced. Alternatively, allowing small business companies to choose to be taxed like partnerships and/or allow trusts to choose to be to be taxed like companies.	11
	#12 – There should be simplification of small business concessions utilising the Board of Tax Report in March 2019. As a start, the various small business thresholds should be aligned again.	13
Capital Gains Tax	#13 - Where a beneficiary of a trust has CGT event E4 apply to a trust distribution solely due to a tax timing difference, such CGT events should be reversed when the timing difference is reversed in a similar way to the rules for AMITs. Alternatively these issues could be dealt with as part of the long awaited review of the taxation of trusts.	13
	#14 – The capital gains tax discount should be reviewed and reconsidered in relation to the effect on investment decisions and whether it is consistent with international comparisons. Alternatives to consider include the reintroduction of CGT indexing; a staggered increase in the CGT discount percentage the longer the asset is held or incorporate it into a general investment income and capital gain discount.	14
Capital Allowances	#16 – Legislation for Temporary Full Expensing/Investment allowance/accelerated depreciation/instant asset write off should be permanently included in the income taxation law with the ability of the Government to turn these allowances on and off as required by the current economic conditions.	14
Value Shifting	#15 - The value shifting rules should be simplified and there should be higher de-minimis thresholds.	15
Capital Losses for Companies	#17 - Consideration should be given to the removal of the quarantining of capital losses of companies by allowing companies to claim capital losses against revenue income and gains. This would then align the treatment of capital losses with the treatment of capital gains for companies. Capital gains for companies are, in effect, already taxed in a similar way to revenue gains.	16
Investment	#18 – The Government should consider introducing tax discount for non-corporate taxpayers that applies across the board to all investment income and capital gains which should be done in conjunction with a review of both the CGT discount, CGT small business concessions & imputation.	16

Fringe Benefits Tax	#19 – Consideration should be given to a repeal of the FBT, with fringe benefits instead assessed to employees as salary and wages. This should be done in a way so as not to disadvantage not-for-profit entities that currently rely on FBT concessions to attract staff.	17
	#20 The Government should change the law regarding car parking fringe benefits to reverse the ATO's changed view of car parking fringe benefits in Taxation Ruling TR 2021/2. The main problem with the ATO's new position is that FBT is now imposed on many suburban and country towns where it did not previously apply. This appears at odds with the initial intent of Car Parking fringe benefits, which was aimed at car parking in CBDs and city centres. Alternatively, fringe benefits tax should only be imposed on car parking if it forms part of the taxpayer's salary packaging arrangement.	18
State Taxes	#21 – The Federal Government should seriously negotiate with the State Governments to reform their inefficient taxes, particularly payroll tax and stamp duties.	19
GST	#22 - The GST rate should be increased and the base broadened in line with other jurisdictions, which would assist the State governments to replace some of their inefficient taxes.	20

Should you have any questions or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

BDO National Tax Technical Leader

APPENDIX

TAX REFORM

Recommendation #1 **The Australian tax reform process needs to be reignited beginning with a holistic review of all the taxes in both the Federal and State tax systems. The Government should also establish an independent Tax Reform Commission that has an ongoing role to develop tax reforms recommendation for the Government. This tax reform process should start with a fundamental review of the interactions between the various taxes and the rest of the economic and social policies of the country.**

BDO have been calling for a holistic review of the Australian tax system for many years. In our opinion, the major view that underpins the need for holistic tax reform is to produce an unambiguous tax system that also provides a fair and efficient means of revenue for the Australian Federal and State Governments. This means that where there are tax concessions provided, they need to translate into increased productivity and opportunity.

Changes to tax rates should also not, on their own, be seen as tax reform. There have been too many instances in Australia as well as overseas, where reductions in tax rates have been sold as tax reform. Changes in tax rates, both increases and decreases, should be used by Governments only as an ongoing fiscal policy mechanism to make adjustments to the economy to take account of inflation, recessions, international tax rate comparisons and government spending requirements. Tax reform should instead be seen as a review and amendment of how all the various elements in the tax system interact with each other and the economic and social aspects of the society. The tax reform process should consistently review these interactions to ensure as much as possible, that the tax system reflects the fundamental aim of all tax policy makers, being to have a simple, efficient and fair tax system.

In terms of practical steps, at a high level there are two steps that need to be taken urgently.

1. Firstly, there is a need to examine Australia's many different types of taxes and rationalise them where possible.

2. Secondly, an independent 'Tax Reform Commission' should be established, which would ensure that the journey of tax reform remains an ongoing process. This Tax Reform Commission could incorporate the Board of Tax's role but have a wider remit covering both Federal and State taxes.

Recommendation #2 **The Australian Federal taxation laws are overly complex and certain income tax laws that have been the subject of prolonged review and discussion should now be implemented. These include the Controlled Foreign Company rules (CFC), review of the taxing of trusts, Division 7A rewrite, Review of small business concessions and Review of CGT rollovers. The review of the CFC provision is particularly important to ensure they are consistent with the Hybrid Mismatch rule and the BEPS Pillar 2 proposal.** **In addition the prolonged process of re-enacting the provisions of the Income Tax Assessment Act 1936 (ITAA 1936) into the Income Tax Assessment Act 1997 (ITAA 1997) should also be expedited.**

Changes to the income tax laws, which have been the subject of prolonged review and discussion for years, should be progressed and implemented. In this regard, BDO particularly single out the controlled foreign company (CFC) rules, which have been the subject of a lengthy review undertaken by the Board of Taxation and then Federal Treasury. This issue has become even more important as the Government needs to ensure the CFC rules are consistent with various other international tax measures recently introduced or proposed by the Australian Government, including, Hybrid Mismatch rules, BEPS GloBE Pillar 2 rules;

The most recent review of the CFC provisions commenced under the auspices of the Board of Taxation in 2006. It was subsequently the subject of a number of Discussion Papers released by the Board and by Treasury, culminating in the release of exposure draft legislation in February 2011. The resulting reforms are now well overdue.
Other reviews undertaken without any implementation include:

- Review of the taxing of trusts;
- Division 7A rewrite;
- Review of small business concessions;
- Review of CGT rollovers; and
- Review of individual and corporate tax residency rules

The Federal income tax laws are overly complex and need simplification. To this end the prolonged process of re-enacting the provisions of the ITAA 1936 into the ITAA 1997 should be expedited. The re-enactment of Australia's income tax legislation from the ITAA 1936 to the ITAA 1997 is a project that is still far from over. Taxpayers face complexity in addressing their taxation affairs. The mere simplification and updating of the language of the Australian income taxation laws that will come with such a redraft is desirable.

COMPANY TAX

Recommendation #3 – 25% company tax rate for all companies

The corporate tax rate should be reduced to 25% for all corporate tax entities to ensure Australia is competitive in attracting international capital to develop our economy. . In addition the current two tier tax rate is causing double taxation as a result of trapped franking credits and administrative complexities for base rate entities and their shareholders.

The 30% company tax rate for larger-sized companies is markedly higher than most other OECD countries including New Zealand, South Korea, US, UK and Norway. Australia's corporate tax rate of 30% is more than 6% above the OECD average.

As the 25% tax rate for base rate entities only applies to companies with less than $50 million aggregate turnover, it does not adequately deal with the competitive disadvantage the 30% company tax rate Australia has for the larger multi-national companies investing in Australia. It is these larger multi-national companies that are affected most by Australia's uncompetitive corporate tax rates, as they are more likely to have mobile capital that can be moved out of Australia and to countries with more competitive corporate tax rates.

While the 25% rate for base rate entities has some short to medium term cash flow advantages for the relevant companies, the advantage is lost when dividends are paid through to resident individual shareholders. This is because of the lower franking offsets received on dividends from base rate entities. From BDO's experience, dividends paid by most base rate entities are ultimately paid to

Australian resident individuals and therefore the only long term beneficiaries of the lower tax rate for base rate entities are a small number of non-resident companies that qualify as base rate entities.

The 25% base rate entity tax rate also causes many complexities and can result in double tax being paid in some case. This double tax can result from trapped franking credits when base rate entities have accumulated franking credits at the 30% rate but can only pay dividends with a 25% franking offset. This can happen when the base rate entity has previously either paid tax at the 30% rate or received franked dividends franked at the 30% rate from a company that is not a base rate entity. In most of these situations, when the base rate entity pays out all its profits as dividends there will be trapped franking credits left in its franking account that will not be able to be utilised by the shareholders. If the shareholders have a marginal tax rate above 25%, they pay additional top tax compared to if they had received 30% franked dividends. This additional top up tax is in effect a doubling of the tax already paid at the company level represented by the trapped franking credits left in the base rate entity's franking account.

BDO suggests the Government consider reducing the company tax rate to 25% for corporate tax entities. This would assist in solving both the competitive disadvantage of the 30% tax rate and the problems caused by having a two tier company tax rate as discussed above. .

Recommendation #4 -Significant Global Entities (SGE)

The Government should consider revisiting the SGE definition to exclude entities with less than $10 million Australian turnover to relieve them of the exorbitant potential penalty rates applicable to SGE's.

Many small foreign owned subsidiaries of large international groups have only a small number of staff who usually have limited tax knowledge and are run by local management in a similar way to locally owned small businesses. However, they are potentially subject to administrative penalties of 500 times the penalties that apply to non SGE small businesses. These potential exorbitant penalties can result in the business of the subsidiary in Australia closing down with the potential loss of employment and local supply chains for the relevant goods or services provided by the subsidiary in Australia. BDO proposes that the SGE definition be subject to a $10 million Australian turnover threshold to ensure such small foreign subsidiaries are competitive with local owned small businesses.

DIVIDEND IMPUTATION

Recommendation #5 -Review of Imputation system

The imputation system should be subject to a post implementation review to identify the relative advantages and disadvantages of the imputation system, including its effect on debt and capital markets, and whether it affects companies' decisions to either invest their profits or pay franked dividends, consider alternative corporate tax systems used by other developed economies and the effect on the overall effective corporate tax rate.

The dividend imputation system has been very popular amongst Australian resident investors and BDO recognised that any proposal to change the dividend imputation system needs to be done carefully and with a good education program identifying the reasons and benefits of such a change. Below are some issues that could be considered in any review of the imputation system.

There are arguments that the imputation system distorts the capital/debt markets and motivates companies to maintain high dividend payout ratios with a built-in disincentive for companies to invest their profits to expand their businesses and puts a relative penalty on overseas investments by Australian companies.

Most other developed countries that had similar systems have disbanded these systems and most have replaced them with a discount for investment income and capital gains. This could be one of the alternatives considered to replace the Australian dividend imputation system.

One of the reasons for the popularity of the current imputation system is the refundability of imputation credits for most resident taxpayers except companies, which was introduced from 1 July 2000 following the recommendation of the Ralph Review of Business Taxation in 1999. This feature of the imputation system has been in place for more than two decades and has been relied upon by many investors when making investment decisions and therefore any proposal to change this feature needs to be carefully considered and introduced with generous transitional/grandfathering concessions.

However, an important consideration in any review of the imputation system should be the effect of refunds of imputation credits on the overall effective corporate tax rate in Australia. The combined tax rate on profits of Australian resident companies that are distributed to non-corporate resident shareholders is based on the tax rate of the shareholder without any minimum rate, which could result in nil or minimal tax rate. Whereas the combined tax rate on profits of companies in most of the other developed countries generally has a minimum tax rate being the relevant corporate tax rate for that country. These differences between the Australian corporate tax system and those of other developed countries needs to be recognised in any review of the imputation system.

Recommendation #6 - Review the 45 day rule

The 45-day rule limiting the availability of franking offsets applies too broadly and should be revised so that it only applies to the specific situations it was meant to stop. The 45 day rule should also be re-written into the ITAA 1997. BDO also notes that the 45-day rule relies on repealed legislation from the 1936 Act, which is difficult to find, its wording is ambiguous and difficult to read and this should be addressed as part of any rewrite.

The 45-day rule for claiming of franking offsets requires resident taxpayers to hold shares at risk for at least 45 days or 90 days for preference shares (not including the day of acquisition or disposal). This rule was introduced to counter inappropriate schemes for the trading in franking credits but its application is so wide that it affects many arrangements that do not relate to franking credit trading. In addition, the provisions for the 45 day rule are contained in a repealed section of the ITAA 1936. As part of the review of the 45 day rule any replacement provisions should be included in the ITAA 1997.

SUPERANNUATION

Recommendation #7 - Increase contribution caps

The level at which contributions caps are currently set does not adequately allow Australians to save for their retirement within the superannuation system, resulting in most of them having to rely, to some extent, on the Government age pension. Therefore the capping of superannuation contributions should be reviewed with the benefit of research into the effect of such capping on superannuation income stream adequacy for the current population of workers and not based on any disproportionate advantage that some current retirees may have been able to obtain from previous policy defects of the superannuation regime. The Government could consider the replacement of annual contribution caps with a lifetime contribution cap to provide for workers who can only afford to make additional contributions later in their working life.

The level at which the concessional contributions cap are currently set does allow individuals to appropriately save for their own retirement within the current superannuation system. In particular, the contributions cap restricts them from saving for their retirement during their later years of working, generally in which such saving is financially affordable for them.

Whilst many taxpayers save for their retirement progressively during the years that they are earning income, it is simply not affordable for the vast majority of the taxpaying community to do so. With the costs of rent and mortgages, raising and educating children taking almost all or most of their funds during their early and middle income producing years, most of them do not have the extra funds to put into retirement savings until towards the end of their working lives. Over the last 10 years, the concessional superannuation contribution cap for older workers has reduced by three quarters from $100,000 p.a. to $25,000 p.a.

The previous Government's Retirement Income Review indicated that there are a small number of retirees that were able to build up substantial balances in their superannuation accounts during the previous years when there were no or substantially higher contribution caps. There is a perception that the reduction of the contribution caps is in some way rectifying this anomaly. However, the cutting of the contribution caps to such low levels now does nothing to mitigate the possible policy defects that allowed the small number of retires to take inappropriate advantage of the superannuation system in the past.

BDO submits that the level at which the concessional contributions cap is set should be reviewed in light of evidence (either to be collected or, if already collected, to be made public) on the adequacy of such savings for a range of scenarios. Such a review should have regard to the effect of capping on the current population of workers and not based on the people who have obtained a distortional advantage out of the superannuation regime because of the previous more concessional rules.

BDO suggests the best alternative would be to replace the annual contribution cap rules with lifetime concessional contribution cap including appropriate transitional arrangements. The lifetime cap number should be meaningful to allow a person and their family to be self-sufficient in retirement.

TRUSTS

Recommendation #8 – Review the taxation of trusts

The rules around taxing trustees and beneficiaries should be reviewed with urgency.

In 2010, the Henry Review said, "the current trust rules should be updated and rewritten to reduce complexity and uncertainty around their application". Trust reform is also something past Governments have looked at but some trust taxation changes in recent years have in fact complicated the tax system even more. While there has been some reform of the taxation of Australian managed investment trusts, reform of other fixed trusts and discretionary trusts has not proceeded.

The current rules around taxing trusts and their beneficiaries are some of the most complicated and outdated rules in the tax Acts. This is mainly because of awkward interactions between trust law and tax law. These interactions need to be reviewed and the tax law changed to simplify the taxing of trusts and their beneficiaries.

Recommendation #9 – review section 99B

Section 99B of the ITAA 1936 should be revised so that it only applies to the mischief it was aimed at. For example it currently inappropriately applies when accumulated foreign source income is paid to an Australian resident beneficiary who was a non-resident when the trustee derived the income i.e. when the income was outside the Australian tax net.

Section 99B of the ITAA 1936 was drafted to tax resident taxpayers who receive non-taxable distributions from non-resident trusts where the taxpayer would have been assessed on the amount if it had been directly received by the taxpayer when it was derived by the trust. This provision was introduced to catch arrangements put in place by Australian residents to shelter foreign income from Australian tax by deriving the income through a foreign trust, which the trust included the corpus of the trust and made a corpus distribution the Australian resident. However, section 99B is very widely drafted so that it inappropriately catches many other situations. This includes where a taxpayer becomes a resident and receives a distribution of foreign income from a non-resident trust that derived the relevant income while the taxpayer was not an Australian resident.

Section 99B should be redrafted so that it more narrowly applies only to the mischief it was aimed at. As acknowledged on pages 17 and 18 of the 2011 Treasury Consultation Paper 'Modernising the taxation of trust income' s99B, in its generality of language, goes well beyond the mischief it was intended to address, as identified in the Explanatory Memorandum when it was introduced in 1979. The language used should be amended to make it clear that s99B only applies to the application of foreign sourced amounts accumulated in a non-resident trust for the benefit of Australian resident beneficiaries.

Recommendation #10 – review section 100A

Section 100A of the ITAA 1936 relating to reimbursement agreements should be clarified and rewritten to provide certainty for taxpayers and advisers. In particular, to clarify the exclusions from a reimbursement agreement for agreements entered into "in the course of ordinary family or commercial dealings". The recent release of TR 2022/4 and PCG 2022/2 does provide some guidance in relation to the ATO's compliance approach and examples of cases that may fall within specific risk categories. The legislation should be rewritten in order to improve the integrity and effectiveness of these measures.

Section 100A is a detailed and complex provision. However since its introduction more than 40 years ago there has been minimal judicial guidance regarding its application.

Specifically, the operation of section 100A turns on the existence of a "reimbursement agreement". This is defined in section 100A(7) to mean an agreement … that provides for the payment of money (referred to in s100A(10) or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the beneficiary or the beneficiary and another person or other persons.

Further explanation of what is a "reimbursement agreement" is found in succeeding subsections of s100A. The most important is s100A(13) which defines an "agreement". However, an agreement may be excluded from the operation of s100A if the agreement is entered into "in the course of ordinary family or commercial dealings". The issue is there has been limited judicial interpretation of the meaning of an "ordinary family or commercial dealing" as it applies for the purposes of s100A.

The ATO has recently issues Taxation Ruling TR 2022/4 and Practical Compliance Guide PCG2022/2, which gives its view of the interpretation of Section 100A and the ATO's intended compliance activities in relation to past and future arrangement that may have section 100A apply. While BDO appreciates the ATO releasing these guidance materials, there is still little judicial guidance on the meaning of "in the course of ordinary family or commercial dealing" .

The application of the "ordinary family and commercial dealing" exclusion still needs clarification. Clearly, what is required is for s100A to be clarified and rewritten to provide certainty for taxpayers and advisers.

SMALL TO MEDIUM ENTERPRISES

Recommendation #11 – review SME structures

The structures used by SMEs should be reviewed and the establishment of a "small or medium business company" concept could be considered, allowing small business companies to choose to be taxed like partnerships; and/or allow trusts to choose to be to be taxed like companies.

SMEs utilise various types of structures including sole traders, partnerships, trusts and companies. Most of these structures have complex tax and other legal rules that can cause real risks for many small businesses. Unfortunately, many of these small businesses and some of their advisers are not aware of all these risks. There are a number of alternatives that could be considered to help small businesses to comply with their tax requirements. Some of these are discussed below:

'Small or medium business entity'

A common cause of frustration for small to medium business entities is that they are subject to the same technical requirements as their much larger competitors, without having access to the resources that their competitors have to manage compliance with these provisions. Therefore a new official definition of a 'small or medium business entity' should be introduced for the purpose of identifying these entities and providing taxation safe harbours to small, entrepreneurial entities so that in their early stages they can concentrate on growing their businesses rather than complying with technical tax legislation.

This concept of 'small or medium business entity 'could be either just for tax purposes or it could be introduced into the *Corporations Act 2001* (Cth) so it could be used more generally to identify small or medium business entities for other purposes.

BDO also recommends including a list of Divisions in the ITAA 1997 that this new entity type would be exempt from in the Tax Acts. This should further reduce compliance costs for these types of entities

This definition would provide safe harbour treatment in relation to a number of technical tax matters, such as thin capitalisation, the CFC rules, transfer pricing, the debt/equity rules (the turnover threshold for 'debt treatment' of interest free shareholder loans was the provision upon which this suggestion is modelled) and application of various FBT exemptions i.e. the small business car parking exemption where there is an existing similar exemption.

The nature of the safe harbours should also be the subject of consultation but should be designed to be easy to apply, 'bright line' tests to give taxpayers the required certainty. The required definitions could be incorporated into the existing Division 328 and would therefore require aggregation of turnovers of connected entities and affiliates which would act as an integrity measure.

Small companies taxed as partnerships

As an alternative to a small business company, small companies could be allowed the right to choose to be taxed as a partnership. Many small companies are set up only to provide asset protection for the business operators and generally most of the profits are distributed to the company shareholders each year. If companies could elect to be treated as a partnership it would cut out many complex tax integrity rules associated with companies and their shareholders. There would be a material saving in compliance costs for many small companies and their shareholders if they could elect into being taxed on a transparent basis in a manner similar to partnerships. A model for such an approach is provided by the tax treatment of 'S-corporations' in the United States.

Trusts taxed as companies

Trust estates could also be allowed a right to choose to be taxed as a company. While we would be hesitant to advocate this being a mandatory approach applying to trusts generally, there may be a case for allowing trusts to opt into such an approach.

Many small businesses in this country use a structure that is a combination of a trust and a company as it gives them flexibility and in many cases assets protection. However, that structure requires small business to deal with some of the most complex provisions in the tax system including the trust taxing provisions and Division 7A for private company loans, payments and debt forgiveness to shareholders and associates. Removing this burden from such taxpayers, by allowing elective corporate tax treatment to trusts, would alleviate this issue and is in line with the Board of Taxation's recommendation in its 2014 report into Division 7A.

Recommendation #12 -Small business tax concessions **There should be simplification of small business concessions utilising the Board of Tax Report in March 2019. As a start, the various small business thresholds should be aligned again.**

Current tax concessions for small businesses are too complex and should be simplified. The small business CGT provisions are one of the most complex pieces of tax legislation and it is very difficult for small business and some of their advisers to understand and follow them correctly without specialist help. To provide another example, the small business company tax cut legislated in 2017 demonstrates how a simple tax measure intended to assist small businesses can become grossly over complicated with unnecessary confusion and complexity.

The Board of Tax Report on Small Business concessions in March 2019 is a good start for the review and rewrite of Small Business Concessions

As an interim measure the various small business thresholds should be aligned again, in particular, the small business CGT threshold of $2 million for eligibility to the small business CGT concession should be reviewed and aligned with the $10 million turnover test for small business restructure rollovers. In addition, the $6 million net asset value test should be reviewed to take account of increased asset values due to inflation.

CAPITAL GAINS TAX

Recommendation #13 - CGT event E4 **Where a beneficiary of a trust has CGT event E4 apply to a trust distribution solely due to a tax timing difference, such CGT event should be reversed when the timing difference is reversed in a similar way to the rules for AMITs. Alternatively these issues could be dealt with as part of the long awaited review of the taxation of trusts.**

CGT event E4 applies where a holder of an interest in a trust receives a distribution from the trust which is not otherwise assessable. In those circumstances, the cost base of the beneficiary is reduced to the extent of the distribution, except where the distribution exceeds such cost base, with the amount of any such excess being a capital gain. Differences between the distributable profit of the trust and its section 95 net income can be either permanent differences or temporary timing differences. An example of a temporary timing difference is where the depreciation rate for tax is higher than that used for accounting, resulting in a deferred tax liability. This usually results in a CGT event E4 and the reduction of the CGT cost base of the interest in the trust and possibly a CGT gain if the amount is more than the cost base of the interest in the trust. Currently, apart from for AMITs, when a timing difference is subsequently reversed, there is no reversal of CGT cost base reduction or reversal of the CGT event E4 capital gain that previously applied.

There is also an issue where a timing difference results in a deferred tax asset that is subsequently reversed. There is no increase in the CGT cost base of the units on creation of the deferred tax asset but on the reversal of the deferred tax asset it results in a CGT event E4 and a reduction of the CGT cost base and a possible CGT gain. For example, the accounting depreciation rate exceeding the taxation depreciation rate will result in a deferred tax asset, that when reversed may result in CGT event E4. This could be addressed by adding to the cost base of an interest in a trust where the amount of a timing difference assessed under Division 6 of Part III ITAA 1936 exceeds the amount of the relevant distribution.

Alternatively these issues could be resolved as part of the long awaited review of the taxation of trusts.

Recommendation #14

The capital gains tax discount should be reviewed and reconsidered in relation to the effect on investment decisions and whether it is consistent with international comparisons. Alternatives to consider include the reintroduction of CGT indexing; a staggered increase in the CGT discount percentage the longer the asset is held or incorporate it into a general investment income and capital gain discount.

The CGT discount was introduced in 1999 as an alternative to the CGT cost base indexing that previously applied. The indexation of CGT cost bases was replaced with the CGT Discount with the experience of very high inflation rates during the 1980's and 1990's and it was seen that the CGT discount would provide a reasonable offset for the loss of indexation. However, since then Australia's inflation has generally been low. Although inflation has recently increased it is not expected to reach the high rates on the 1980's and 1990's. Therefore this approach could be reconsidered to see if it is still appropriate. One of the other reasons for the replacement of the cost base indexation was because of the complex calculation required for a capital gain. However, with most capital gains being calculated electronically these days this should not now be seen as so much of a problem.

Some alternatives to the 50% CGT discount include:

- Reintroducing the indexation of CGT cost bases;
- Staggered increase in the CGT discount percentage the longer the asset is held.
- Decreasing the CGT discount to 25%;
- Incorporate the CGT discount into a comprehensive investment income and capital gain discount as mentioned in recommendation 6 above.

However, as the CGT discount system has been in place for more than two decades any change should include generous transitional and grandfathering rules.

CAPITAL ALLOWANCES

Recommendation #15 – Investment allowance

The rules for temporary full expensing/Investment allowance/accelerated depreciation/instant asset write-off rules should be permanently included in the Income Tax law with the ability of the Government to switch these allowances "on and off" as required by the current economic conditions.

A business investment allowance is a common tool used by Governments for economic stimulus. It can be either an additional tax deduction available for the purchase of plant, property and equipment or an acceleration of the depreciation deductions to encourage businesses to invest in income-producing business assets. Over the past three years in response to the COVID-19 pandemic, we have seen multiple iterations of this allowance such as the evolvement of the $150,000 instant asset write-off into the more recent immediate expensing of assets regime with multiple eligibility criteria and added complexity. The reactive rollout of these new measures in a piecemeal fashion has created confusion for businesses or require businesses to seek tax advice with regards to what is currently in place and whether they are eligible to access these incentives. Further, businesses have needed to analyse what will take precedence depending on the date assets are purchased, held or installed ready for use in line with the requirement in Division 40 of the ITAA 1997, or more specifically with reference to the immediate expensing of assets, Subdivision 40-BB of the *Income Tax (Transitional Provisions) Act 1997* (Cth) (“ITTPA 1997”).

BDO recommends that investment allowance rules be permanently placed in the ITAA 1997 with the ability for the Government to switch the investment allowance “on and off” or changing the rate of allowance as is appropriate for the economic conditions at that time. This switching on or off could be done by either having a particular end date or a regular review of the end date. If particular, changes are needed to the investment allowance rules to account for special conditions, it would be just a matter of amending the particular conditions in the rules instead of introducing or recreating new rules every time there is an event with a significant impact on the Australian economy. Further, this would reduce administration costs for many stakeholders as the drafting of the rules would occur only once. Therefore tax advisors, businesses and Government would be familiar with the rules and would not need to review, re-learn and re-communicate the rules each time they are utilised.

VALUE SHIFTING

Recommendation #16

The value shifting rules should be simplified and there should be a higher de-minimis thresholds. There are de-minimis rules that have the effect that where the value of a value shift is less than a set value, the value shifting rules will have no application, however these de-minimis levels are too low and have not been revised since they were introduced in 2002.

The general value shifting regime, introduced in 2002, is an enormously complex piece of legislation with important consequences for all taxpayers. Failing to consider the provisions can result in inadvertently triggering capital gains, either immediately or in the longer term.

BDO appreciates that the value shifting rules address arrangements that shift value out of assets, distorting the relationship between their market values and their values for tax purposes. Without a value shifting regime, these arrangements could encourage the creation of artificial losses and the deferring of gains. However, the rules are essentially not fit for purpose as there are some loopholes which taxpayers can utilise with the rules in their current form. The rules are essentially an overly complex process which tax advisors and businesses are required to review but mostly will not apply.

These rules, as well as being mechanical and prescriptive, can apply in situations where there is clearly no tax avoidance purpose and therefore should be simplified and made conceptual as opposed to prescriptive. Re-writing the rules in a form to reduce compliance costs and avoid confusion amongst advisors and taxpayers would be beneficial.

In the event that the Federal Commissioner of Taxation suspects there is a scheme undertaken by a taxpayer relating to the value shifting rules with a tax avoidance purpose, the simplification of the value shifting rules would not prevent the Commissioner from applying the anti-avoidance rules in Part IVA of the ITAA 1936.

CAPITAL LOSSES FOR COMPANIES

Recommendation #17 - Capital losses for companies

Consideration should be given to the removal of the quarantining of capital losses of companies by allowing companies to claim capital losses against revenue income and gains. This would then align the treatment of capital losses with the treatment of capital gains for companies. Capital gains for companies are, in effect, already taxed in a similar way to revenue gains.

Where a company realises a capital gain, it is often assessed and taxed to the company in an identical manner to the taxation of an equivalent revenue gain. Notwithstanding this, companies continue to be prohibited from deducting net capital losses from their assessable income of current or future years until it makes a capital gain. This can result in the unsatisfactory situation of a company being assessed and taxed on taxable income while simultaneously carrying forward a 'quarantined' net capital loss.

Companies are not entitled to discount their capital gains under Division 115 ITAA 1997, however for assets acquired before 21 September 1999 companies can index the cost base of assets from the date of acquisition to 21 September 1999. This means that for assets acquired after 21 September 1999, companies are in effect taxed on capital gains almost the same as for revenue gains except that any capital losses made by a company are quarantined and can only be offset against current or future capital gains.

By not allowing companies to apply the CGT discount in Division 115, it appears that the Parliament intended capital gains on assets acquired after 21 September 1999 should be taxed like revenue gains, however the quarantining of capital losses is not consistent with this apparent policy intent.

Consideration should be given to the removal of the quarantining of capital losses of companies and to simplify the process this treatment could apply to assets acquired both before and after 21 September 1999 if the companies are prepared to forgo any residual indexation of the cost base of their CGT assets acquired before 21 September 1999.

Accordingly, the law should be amended so that such a company can immediately deduct such a capital loss, for all income tax purposes. Arguments that capital losses should continue to be quarantined because taxpayers can control the timing of such losses are not persuasive. The timing of an equivalent revenue loss on a similar revenue asset is similarly under the control of relevant taxpayers as are other deduction events such as the writing off of a bad debt. Contrived 'wash sales' can be adequately addressed by application of the general anti-avoidance rule in Part IVA.

INVESTMENT

Recommendation #18 - Investment discount

The Government could consider introducing a tax discount for non-corporate taxpayers that applies to all investment income and capital gains, in conjunction with a review of both the CGT discount, and imputation.

Superannuation's tax-preferred status has enabled it to become the primary savings vehicle for most Australians. Whilst this has been very beneficial for retirement savings, it does little to recognise the necessity for individuals to save income outside of superannuation to afford major capital purchases during their working life. The Henry Review proposed that there should be a savings income discount available to individuals for non-business related net interest income, net residential rental income (including related interest expenses), capital gains (and losses) and interest expenses related to listed shares held by individuals as non-business investments. Such a recommendation may make investments outside of residential property (that is not the family home) and superannuation more attractive. To provide further incentive for Australians to work and invest we support the introduction of an investment income and capital gains discount.

Such a discount could also incorporate the current CGT discount but at a level lower than the 50% rate. It could also be considered in any review of the imputation system as mentioned above.

FRINGE BENEFITS TAX

Recommendation #19 – Repeal FBT

Fringe Benefits Tax (FBT) produces an onerous compliance burden on employers and inappropriate tax outcomes for employees who are on lower income tax marginal rates compared to the FBT rate. Consideration should be given to a repeal of the FBT, with fringe benefits instead assessed to employees as salary and wages. This should be done in a way so as not to disadvantage not-for-profit entities that currently rely on FBT concessions to attract staff.

The Fringe Benefits Tax (FBT) was introduced in 1986 in order to address a perceived shortcoming in the then existing income tax measures (s25(1) and s26(e) of the ITAA 1936) in appropriately taxing non-salary or wage benefits provided to employees by employers. An appropriate response would have been to amend the existing income tax legislation in order to ensure that such benefits were appropriately valued and assessed to the relevant employees. Instead, the Government at the time introduced a whole new tax regime which assessed and taxed the benefits to the employer providing the same. Additionally, it imposed a whole new compliance regime with returns and a taxation year quite different and separate from relevant income tax compliance obligations.

The current design and rate of FBT is such that it is implicitly assumed that employees paying the maximum marginal rate of income taxation should be indifferent as between receiving salary or wages or receiving the equivalent value in fringe benefits. However, the corollary of this is that FBT applies regressively, as it implicitly taxes benefits provided to earners of income whose marginal rates of income tax are less than the maximum marginal rate, at the maximum marginal rate. In other words, in addition to taxing the wrong taxpayer (being the employer rather than the employee), the tax can unfairly penalise the provision of fringe benefits to low income earners. In addition to the above, any alleged simplicity benefits which flow from assessing and taxing the benefits centrally to the employer rather than to the employee, have been substantially eroded by the requirement that the employer separately identify ‘reportable fringe benefits’ attributable to each employee and record the same on PAYG payment summaries provided to the employee and the ATO. This is further exacerbated by the absence of tax consolidation in respect of FBT.

The current paradigm for FBT is also at odds with most other tax jurisdictions. Most other jurisdictions, appropriately, assess and tax to employees, fringe benefits supplied to such employees in respect of their employment. Notwithstanding this mismatch, Australia has made little or no effort to address the international economic double taxation of fringe benefits where they are provided in a “cross-border context”. Australian employers are assessed on FBT in respect of fringe benefits supplied to resident employees carrying out services in foreign jurisdictions which assess and tax employees in respect of the same benefits. Because FBT is not imposed under the Income Tax Assessment Acts and the persons upon whom the Australian and foreign taxes are imposed differ, Australia will provide no relief (under the Foreign Income Tax Offset measures in Division 770 of the ITAA 1997) from the effective double international taxation of the same benefit. FBT is also not a tax that is covered by the majority of double tax agreements (DTAs) which cannot be relied upon to provide relief from double taxation.

BDO recommend a complete repeal of the FBT with compensating concessions for the not-for-profit sector entities which currently rely on FBT concessions to compete with other prospective employers. However if it is decided not to repeal FBT, consideration should be given to amending FBT, so it only applies to genuine remuneration benefits i.e. benefits that are provided as part of an employee's remuneration and not on incidental benefits that are merely provided as a consequence of performing the employment duties.

In addition, if a repeal of the FBT was seen as not achievable, consideration should be given to measures aimed at reducing the FBT compliance burden. Consideration should be given to measures aimed at reducing FBT compliance costs such as allowing consolidation of corporate groups for the discharge of FBT liabilities and compliance obligations.

Recommendation #20 - Car parking fringe benefits

The Government should change the law regarding car parking fringe benefits to reverse the ATO's changed view of car parking fringe benefits in Taxation Ruling TR 2021/2 following the decisions in Commissioner of Taxation v Qantas Airways Limited [2014] FCAFC 168 (Qantas) and Virgin Blue Airlines Pty Ltd v Commissioner of Taxation [2010] FCAFC 137 (Virgin Blue). The changed law should reinstate the position as per the ATO view in previous TR 96/26 (now withdrawn). Car parking FBT is now imposed on many suburban and country towns where it did not previously apply, which is at odds with the initial intent of car parking fringe benefits, which was aimed at car parking in CBDs and city centres.

Alternatively, fringe benefits tax should only be imposed on car parking if it forms part of the taxpayer's salary packaging arrangement. Another alternative is FBT on car parking should be limited to certain areas such as the CBD or city centres where there is generally adequate public transport available.

On 16 June 2021, the Australian Tax Office (ATO) released Taxation Ruling TR 2021/2 on car parking fringe benefits and withdrew TR 96/26 updating its view that existed for more than 20 years.

The main concern with final ruling is that it results in many more employers being subject to FBT on the provision of car parking to employees from 1 April 2022.

The ATO has expanded on its view in the draft ruling that certain shopping centre paid car parks (and other car parks with similar arrangements) that were previously excluded as commercial parking stations in TR 96/26, may now be captured as "commercial car parking facilities". The final ruling includes virtually all such car parks that charge a fee for all day parking above the car parking threshold even if it has a primary purpose other than providing all-day parking (e.g. parking at a hospital or shopping centre that has a two or three hour free parking period with a penalty rate for longer term parking).

Another impact of the revised ATO view is on the small and medium business car parking exemption in Section 58GA, which applies to businesses with an aggregated turnover up to $50m. The small and medium business car parking exemption does not apply when the car is parked at a commercial parking station. As an example, where a small or medium business employer has business premises at a shopping centre and the employees are allowed to park at the shopping centre carpark. If the shopping centre car park is considered a commercial parking station under the new interpretation, then small or medium business would no longer be eligible for the small business car parking exemption.

The extension of car parking fringe benefits as a result of the Qantas and Virgin Blue decisions and subsequent final ruling, highlights that the FBT car parking rules have not kept pace with the changing world. We submit that it is time to fundamentally review the FBT car parking rules, to ensure that while car parking benefits provided as part of a salary package (most likely in a CBD location) are subject to FBT, other car parking arrangements (such as staff parking at a suburban and country town shopping centre) should not be subject to FBT. It is also noted that in many such suburban and country town situations there is not appropriate public transport, so the employees are forced to drive to work.

The Government should change the law regarding car parking fringe benefits to reverse the ATO's view of car parking fringe benefits following the Qantas and Virgin Blue decisions and in effect reinstate the ATO view in TR 96/26

Alternatively, fringe benefits tax should only be imposed on car parking if it forms part of the taxpayer's salary packaging arrangement.

Another alternative is FBT on car parking could be limited to certain areas such as the CBDs or city centres where there is generally adequate public transport available.

STATE TAXES

Recommendation #21 -State tax reform

The Federal Government should seriously negotiate with the State Governments to reform their inefficient taxes, particularly payroll tax and stamp duties.

Of the country’s taxes, State payroll taxes and stamp duties have been consistently criticised and place a significant burden on businesses.

Stamp Duty

BDO notes that some of the States are indicating a willingness to join with the Federal Government to consider repealing certain State taxes, such as Stamp Duty in return for a proposed increase in GST. BDO supports this initiative as it will promote simplifying the taxation system and reduce compliance costs for businesses and other stakeholders.

Payroll Tax

The Henry Review considered the potential to consolidate payroll taxes into a single tax on employee remuneration administered through the PAYG withholding system. It also recommended replacing payroll taxes with revenue from more efficient broad-based taxes that capture the value-add such as GST. Each of these options would require careful consideration of implications associated with altering the current payroll tax base, as well as how to distribute revenue between States and Territories, but are worth examining for their potential to significantly improve the efficiency of our tax system (including by reducing tax administration). While BDO does not propose any specific reforms to specifically deal with the payroll tax administration challenge, it is conceivable that a reform program similar to the implementation of the GST could facilitate the removal of State based taxes such as payroll tax subject to their replacement with a suitable alternative. Critical to any reform efforts will be to adopt a national approach. The Commonwealth, States and Territories should work together (rather than individually) to identify reform opportunities that are the most fruitful.

GOODS & SERVICES TAX

Recommendation #22 – GST reform

The Goods & Services Tax (GST) has been conspicuously missing from the tax reform debate. The GST rate should be increased and the base broadened in line with other jurisdictions.

The main rationale for bringing in the GST and giving the revenue to the States was that it would enable them to review their taxes, and remove some of the States' inefficient or inequitable ones. They have done that to some extent, but not to the extent that was expected when the GST was introduced. The GST is seen as a modern and, efficient tax that could actually replace some of these archaic taxes that the states are currently using, particularly stamp duty. Having identified problems in respect of payroll taxes and stamp duties, the funding of the removal of such inefficient taxes could be provided by a broadening of the tax base of the GST and/or an increase in the rate of such tax.

BDO Recommends the GST rate should be increased to 15% across a broadened base with appropriate compensation to ensure that it is fair and equitable. Australia's 10 % rate is very low compared to the 15 to 20% in other countries that have GST/VAT.