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Tax White Paper Task Force  
The Treasury  
Langton Crescent  
PARKES ACT 2600

1 June 2015

Dear Sirs and Mesdames

**RE:THINK - TAX REFORM DISCUSSION PAPER**

BDO welcomes the opportunity to provide a submission on the *Re:Think* - Tax Reform Discussion Paper released by Treasury for public consultation.

We make the submissions set out in the Annexure to this letter.

Should you have any questions, or wish to discuss any of the comments made in the annexed submissions, please do not hesitate to contact Lance Cunningham on 02 9240 9736 or [lance.cunningham@bdo.com.au](mailto:lance.cunningham@bdo.com.au) or Matthew Wallace on 02 9240 9760 or [matthew.wallace@bdo.com.au](mailto:matthew.wallace@bdo.com.au).

Yours sincerely



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<b>BDO Tax Reform Discussion Paper Submission - Annexure</b>	
<b>Tax Reform Discussion Paper Questions</b>	<b>BDO comments</b>
<p>1. 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?</p>	<p>While some parts of the tax system only require refinement, many others may need more fundamental change. Examples of situations that may need a more fundamental change to the tax system include:</p> <ul style="list-style-type: none"> <li>• the tax mix between Federal and State Governments that causes vertical fiscal imbalance may need the abolishing of some taxes such as stamp duty and the broadening of other taxes to compensate</li> <li>• Fringe benefits tax may need to be abolished and replaced with a simplified system of including remuneration fringe benefits in the employees' assessable income.</li> <li>• The tax policy around International supply chain transactions has not kept up with the commercial and technological realities and will need a fundamental change to how these transactions are dealt with to ensure an appropriate split of tax revenue between the various jurisdictions involved in the supply chain. The treatment of intellectual property is one of the most important aspects in this regard.</li> <li>• The taxation of digital transactions has not needed to be considered until recently but it will become increasingly important with more and more transactions taking place on the internet. Given the inherent statelessness of many of these digital transactions it is important to have a global approach to this issue.</li> </ul>
<p>2. 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?</p>	<p>Australia's Tax system is too complex for it to quickly change in response to the evolving structure of the Australian and International economy.</p>

<p>3. How important is it to reform taxes to boost economic growth? What trade-offs need to be considered?</p>	<p>Many taxes are a drag on Australia’s economic growth, including stamp duties, high corporate tax rates, payroll taxes etc. These taxes should be either abolished or rates reduced to a level that has a less dramatic drag on the economy. The trade-offs required for these reforms will differ for each tax. For example:</p> <ul style="list-style-type: none"><li>• The reduction of company tax to a level that is more competitive with OECD average may result in an equal or increased overall tax take as a result of increased Australian economic activity by companies.</li><li>• The reduction in revenue from abolishing stamp duties could easily be replaced by more efficient and equitable taxes such as a more broad based land tax.</li><li>• An increase in the breadth and scope of consumption taxes (such as the GST) is likely to result in an increased tax take given difficulty in avoiding such taxes without burdening economic growth and activity. Such an increase could pay for the abolition of various inefficient taxes and the reduction of personal and corporate income tax.</li></ul>
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4. To what extent should reducing complexity be a priority for tax reform?

The reduction of complexity should be a priority of tax reform but the desire for simplicity needs to be kept in perspective with the other requirements of a good tax system being fairness and efficiency. A certain amount of complexity may be required to achieve an appropriate level of equity and/or efficiency in the tax system.

In addition, Australia and most other developed countries have complex economies and as a result the tax system will also have to have a certain amount of complexity but reduction of complexity where possible should always be in the mind of tax policy makers.

Complexity in the tax system needs to be kept to a minimum as it can be one of the biggest causes of unnecessary compliance costs and also encourages some taxpayers to look for ways to minimise or avoid their tax liabilities.

The interaction of many simple tax and/or transfer measures can also result in complexity. Therefore a holistic approach must always be taken when introducing new tax policy to ensure the interaction with other tax and transfer policies does not create unnecessary complexity.

The Tax System will always have to determine the appropriate trade-off between simplicity and fairness and efficiency. Much of the complexity in the current tax system can be seen as a result of one off changes that attempt to resolve apparent fairness issues. However, in many instances the complexity of the system is a factor that contributes to the unfairness of the system by making the system too complex for many people to understand.

It is important that when tax systems are being designed or amended, the first rule should be to ensure simplicity of the system and if unfairness is identified in the system any changes are the

	least complex there can be to achieve the appropriate level of fairness.										
5. 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?											
6. What should our individuals income tax system look like and why?	<p>The progressive individual tax system should be reformed with the number of brackets reduced and the rates also reduced. An example of a suggested approach may be as follows:</p> <table data-bbox="842 808 1305 987"> <thead> <tr> <th>Taxable income</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>0 - \$15,000</td> <td>nil</td> </tr> <tr> <td>\$15,000 - \$50,000</td> <td>20%</td> </tr> <tr> <td>\$50,000 - \$200,000</td> <td>30%</td> </tr> <tr> <td>\$200,000+</td> <td>47.5%</td> </tr> </tbody> </table> <p>The reduction in rates and the broadening of bands reduces complexity and removes bracket disincentives. The “middle band” of 30% is directed at minimising imputation complexities and concerns by linking the individual tax rate to the corporate tax rate.</p> <p>All levies (e.g. the Medicare levy and the Budget Repair levy) should be abolished to further reduce complexity.</p> <p>The Income thresholds should be regularly reviewed to counter ‘bracket creep’ and ensure alignment with the social security system.</p>	Taxable income	Rate	0 - \$15,000	nil	\$15,000 - \$50,000	20%	\$50,000 - \$200,000	30%	\$200,000+	47.5%
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0 - \$15,000	nil										
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\$200,000+	47.5%										

<p>7. What should our fringe benefits tax system look like and why?</p>	<p>Fringe Benefits Tax should be abolished and replaced with a simpler system for taxing employee fringe benefits to the employee by including the value of the benefits in their assessable income.</p> <p>The fringe benefits included in the employee's assessable income should only be those benefits that are 'remuneration benefits' i.e. benefits that are obviously directly or indirectly part of the employee's salary package. Benefits that are obviously employment duty related benefits should be excluded from being taxed.</p> <p>If employment related benefits are subject to tax deductibility restrictions, e.g. entertainment, which should be dealt with as non-deductible in the employer's income tax return, rather than the employee's.</p>
<p>8. At what levels of income is it most important to deliver tax cuts and why?</p>	
<p>9. To what extent does taxation affect people's workforce participation decisions?</p>	<p>The greatest impact the tax system has on people's work force participation is in relation to the interaction between the tax and welfare systems. The high effective marginal tax rates when transferring from welfare to paid work can be a big disincentive for workplace participation.</p>
<p>10. To what extent are the interactions between the tax and transfer system straightforward for the people who deal with both systems?</p>	<p>See answer to question 9.</p>
<p>11. How important is tax as a factor influencing people's decisions to work in other countries?</p>	
<p>12. To what extent is tax planning a problem in the individuals income tax system? Are existing integrity measures appropriate?</p>	
<p>13. What creates incentives for tax planning in the individuals income tax system? What could be done about these things?</p>	

14. Under what circumstances is it appropriate for assistance to be delivered through tax offsets?	
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15. To what extent do our arrangements for work-related expense deductions strike the right balance between simplicity and fairness? What could be done to improve this?

The ability to claim work related expense deduction is very important for some people who are required to incur unreimbursed expenses in order to perform their employment duties.

This is a difficult area for the Australian Taxation Office (ATO) to monitor because of the cost involved in checking the large number of taxpayers claiming relatively small amounts. The lack of review by the ATO in this area may be prompting some taxpayers to over claim their work related and this has prompted some suggestions to eliminate work related expense deductions for employees. However, this could have a detrimental effect on those taxpayers that do have genuine work related expenses.

An alternative could be to introduce an optional standard deduction for all employees that gives employees the option to claim more than the standard deduction, provided they have appropriate substantiation documentation. This would reduce the number of taxpayers that the ATO would have to monitor in relation to these deductions.

The option to choose a standard deduction would simplify individual taxpayer reporting by making it easier for basic PAYG employees tax returns to electronically prepared using prefill data and the ATO could issue an assessment that employees could accept or alter (depending on what else they may have to declare).

However it is important that the standard deduction be provided as taxpayer's choice. If there was a financial limit on work related deductions this would introduce an inappropriate distortion to the tax system.

Use car expenses as an example - may businesses cannot afford to have a fleet of vehicles to allow their staff to undertake the occasional travel required for work. Instead they



	<p>encourage the staff to use their personal vehicles and the employer will reimburse the employee for the use of their personal asset. This recompense is usually in the form of a cents-per-kilometre car allowance, which is taxable income and required to be reported on the employee’s payment summary.</p> <p>It would be inequitable that the employee be required to include this car allowance as income but be denied a tax deduction for the costs incurred in deriving that car allowance.</p> <p>If work related expenses are restricted financially in terms of amounts that can be deducted it will actively discourage employees from incurring those costs, and introduce inefficiencies into doing business.</p> <p>BDO submits that those businesses that would be penalised would be many small businesses who cannot afford large overheads.</p>
<p>16. To what extent does our fringe benefits tax system strike the right balance between simplicity and fairness? What could be done to improve this?</p>	<p>The FBT is too complex for the job it is attempting to do. FBT was introduced as an integrity measure to support the income tax base where it was thought the relevant income tax provisions (mainly former section 26(e) of the Income Tax Assessment Act 1936) did not provide for sufficient certainty around the valuation of employee benefits. The introduction of FBT as a replacement for section 26(e) was an overreaction to the valuation issues in section 26(e).</p> <p>As discussed above in the answer to question 7, we suggest that FBT should be abolished and replaced with a return to a simplified system of including the remuneration fringe benefits in the employee’s taxable income.</p>

<p>17. To what extent are the concessions and exemptions in the fringe benefits tax system appropriate?</p>	<p>Many of the concessions in the FBT system have been put in place to counter the unfairness of some of the provisions. The concessions are there as a result of the wide net cast by the broad definition of 'fringe benefit' in section 136 of the FBT Assessment Act. If the system of taxing fringe benefits was simplified to only tax true remuneration fringe benefits, as discussed in answers to questions 7 and 16 above, most of the concessions would not be required.</p>
<p>18. What tax arrangements should apply to bank accounts and debt instruments held by individuals?</p>	<p>The tax arrangements applicable to bank accounts and debt instruments should not differ from current treatment. No special regime should be introduced (keeping in mind simplicity as the cornerstone of the tax reform process).</p> <p>Interest earned on bank accounts should continue to be assessable. Interest paid on debt instruments that are used for an income-producing purpose should continue to be deductible.</p>

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

The capital gains tax (CGT) discount was introduced in 1999 as a replacement for CGT cost base indexation. The CGT cost base indexation was previously in place to ensure that CGT was not being imposed on gains that were there only because of inflation. The CPI indexation calculation could sometimes be cumbersome and therefore it was replaced with the 50% CGT discount primarily as a simplification measure.

At the time that indexation was replaced with the 50% discount in 1999, the inflation rate was reasonably high and had been even higher in the two decades before that. Therefore, at that time the 50% discount was seen as a reasonable substitute for the average of the CGT cost base increases as a result of CPI indexation. However, with the current environment of very low inflation the 50% discount may be providing a higher tax benefit than was originally intended when compared to the current CPI increases.

Although the 50% discount was introduced as a simplification measure, it also caused complexity when interacting with other tax measures. The main complexity is probably the interaction with negative gearing of real estate investments. While negative gearing of its self does not create upward pressure on residential real estate prices there are some indications that negative gearing in combination with the CGT discount could do so.

The 50% CGT discount may also be providing an increased incentive for investors to invest in residential real estate rather than other investments.

Negative gearing and the CGT discount are not confined to residential real estate investments. For example the same principles equally apply to other investments such as investments in company shares, unit trusts, businesses etc. However, the difference between investments in

	<p>residential real estate and investments in these other investments is the limited supply of residential real estate and the increasing population of Australia, which are also putting a constant pressure on the prices of Australian residential real estate. This ensures that the prices of residential real estate in Australia in most large cities and many other areas have generally increased substantially above the CPI index.</p> <p>The substantial increase in the price of residential real estate above the CPI indicates that the use of the 50% discount for residential real estate may not be an appropriate substitute for CPI indexation of the CGT cost base.</p> <p>If a return to CPI indexing is not seen as appropriate, the 12 month rule for CGT discount could move to say a 3 year rule to minimise the tax advantages of short term investments or those property investments that may be more akin to developments than investments.</p>
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<p>20. To what extent does the dividend imputation system impact savings decisions?</p>	<p>The provision of Imputation offsets under the dividend imputation system may appear to provide an incentive to other investments that do not provide such offsets, such as interest bearing investments. However, this is taking a too simplistic view of the imputation system and the taxation of company profits.</p> <p>The imputation system provides a flow through of tax paid by the company to the resident shareholders who receive the distribution of the tax paid profits. This means the company tax payments could be seen as a prepayment of the shareholders tax liability.</p> <p>When the company tax paid is looked at as a prepayment of the shareholder's tax liability, the comparison with an investment in an interest bearing investment is not that different. The payment of interest by the issuer of the interest bearing investment is tax deductible to the issuer. Therefore the holder of the investment will pay all the tax on the interest income received from the overall investment. If we assume an equal rate of return on both the interest bearing investment and the company's profit making activities, the overall tax paid on both investments is the same.</p> <p>(I may insert a worked example here to highlight this issue further)</p>
<p>21. Do the CGT and negative gearing influence savings and investment decisions, and if so, how?</p>	<p>Please see comments regarding CGT Discount and negative gearing in our answer to question 19 above.</p>

22. How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

The most important characteristics of a retirement income system are that it is easy to understand and that it remains fairly consistent. Australia's superannuation system has not passed either of these tests over recent decades.

The superannuation system has had too many add-ons to it in an effort to either simplify or deal with apparent unfairness but in the process the overall system has become unwieldy and complex.

Although there may be a good case for a total review of the superannuation system care must be taken not to make too many changes that would affect taxpayers who are in retirement or close to retirement. Such taxpayers have planned or are making plans for their retirement funding based on the current rules so it would be inequitable to make too many changes to the rules. If major changes are to be made they should be introduced with simple transitional rules that look to reduce any disadvantage of changes to taxpayers already in retirement or about to retire. in retirement or about to retire.

Subject to the above comments below are some suggestions to be considered as part of any review of the retirement incomes system:

- Consideration could be given to going back to the system that provides tax free contributions to and accumulations in the superannuation fund and with taxable withdrawals. This is the system used in most other countries with similar superannuation/pension systems and it used to be the system in Australia. This would allow the funds invested in superannuation to build faster and also remove some of the inconsistencies caused by tax free withdrawals.
- Alternatively, withdrawals from superannuation remain partially tax free but only to a threshold amount. For example, the first say \$75,000 of pension payments are to be exempt however amounts above

	<p>that (including any income earned from other sources) to be taxed at the taxpayers prevailing marginal rate (akin to section 23AG ITAA 1936). However appropriate adjustments may need to be made to the taxing of contributions or fund income to compensate for the additional tax paid under this system. For example consideration could be given to reducing or eliminating tax on the contribution to and/or income of the superannuation fund.</p> <ul style="list-style-type: none"> <li>• A tightening on the minimum and maximum amounts allowed to be withdrawn so as to ensure less reliance on pension system but also ensure capital re-enters the economy. We suggest the minimum remain at 4% or the net profit of the fund for the year (whichever the greater) and a maximum amount introduced of say 10% of the fund to ensure people do not immediately gift super to access the pension.</li> </ul>
<p>23. What other ways to improve the taxation of domestic savings should be considered? How could they be applied in the Australian context?</p>	

24. 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 corporate tax rate needs to be competitive with that of the other countries that are competing with us for foreign capital investments. The OECD average is about 24% and therefore we should be looking to reduce the Australian tax rate to about that rate at the least.

In addition to the requirements to have a competitive tax rate compared to other capital importing countries, the reduction of the corporate tax rate can, in fact, result in the same or more tax being collected by the Government. This is as a result of the additional after tax profits being available to invest in more income producing activities resulting in higher profits and increased wages or numbers of employees, resulting in more tax payments from them.

As discussed above in the answer to question 20, the corporate tax payments should be seen as a prepayment of tax for resident shareholders and therefore the reduction of the corporate tax rate should be seen (in the context of Australian resident shareholders) as only a temporary reduction of tax receipts by the Government because most shareholders will be paying the shortfall in additional top-up tax when receiving dividends from the companies.



<p>25. Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?</p>	<p>The dividend imputation system is continuing to serve Australia well. The imputation system has helped increase the investment in Australian companies by Australian investors; this has contributed to shielding both the Australian companies and the Australian shareholders from some of the worst effects of the recent Global Financial Crisis.</p> <p>There is an argument that with the Australian economy becoming increasingly open to the global economy it gives more reason to ensure we are not too exposed to the vagaries of some of the overseas markets.</p> <p>However, if it is seen as worthwhile to increase Australian foreign investments an alternative could be to allow foreign tax paid by Australian companies to be passed through to the shareholders as franking offsets. This would diminish the perceived disincentive for Australian companies to invest offshore as it would help stop the double taxation of many foreign investments by companies when the foreign profits are paid out to shareholders.</p> <p>( I may provide a worked example of the double tax on foreign investments by companies)</p>
<p>26. To what extent would Australia benefit from the mutual recognition of imputation credits between Australia and New Zealand?</p>	
<p>27. 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?</p>	
<p>28. How complex is the tax treatment of capital assets and are the costs of compliance significant?</p>	
<p>29. 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?</p>	<p>The ATO's current approach to the operation of the same business test discourages innovation as taxpayers are less likely to conduct peripheral activities that endanger the satisfaction of the SBT.</p>

<p>30. How could the current tax treatment of intangible assets be improved?</p>	
<p>31. 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?</p>	
<p>32. To what extent does the tax treatment of foreign income distort investment decisions?</p>	<p>Most foreign investments by Australian companies results in double taxation with very high overall tax rates when the foreign profits are paid out to Australian shareholders as unfranked dividends. A good way of alleviating this would be to allow the flow through of foreign tax paid by companies to the companies' shareholder by allowing franking offsets for the foreign tax paid as we discussed in answer to question 25 above.</p> <p>In addition, the changes to the controlled foreign company provisions that were proposed under the now, not so recent review by Treasury of the controlled foreign company provisions which, most recently resulted in the release of exposure draft legislation in 2011, should again be considered. The changes proposed under that review would have resulted in material reductions in the compliance obligations associated with those provisions.</p>
<p>33. 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?</p>	
<p>34. How can tax avoidance practices such as transfer pricing be addressed without imposing an excessive regulatory burden and discouraging investment?</p>	<p>BDO supports the ATO's current initiative on the simplified reporting rules for transfer pricing. Our experience is that these new rules have been received well by clients.</p>

<p>35. 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?</p>	
<p>36. 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?</p>	<p>The current CGT system as it applies to companies effectively taxes capital gains derived by companies in the same way as income. The exception is in relation to capital profits made by companies. Capital losses can only be offset against capital gains. As companies receive virtually no concessions under the capital CGT rules (other than small companies that may receive the small business concessions), we suggest the taxing of capital gains and losses and the taxing of income be equated. This could be easily done by allowing companies to claim capital losses as deductible against assessable income.</p>
<p>37. 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?</p>	
<p>38. 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?</p>	

<p>39. Does the R&amp;D tax incentive encourage companies to conduct R&amp;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?</p>	<p>In our opinion the R&amp;D Tax Incentive encourages companies to conduct R&amp;D activities that would otherwise not be conducted. The reason is that the incentive reduces the after tax cost of conducting activities and in doing so encourages greater spending in the following ways:</p> <p>Businesses generally want to spend more on research and development. There is an increasing realisation amongst most businesses that research and development is a necessary element in their business development due to the increasing competitive nature of business and the trend toward more rapid technological change. Accordingly, most will spend what they can afford to and if the after tax cost of conducting the activities is less, then more will be spent.</p> <p>The nexus between the existence of the R&amp;D Tax Incentive and additional research and development being conducted is accentuated in respect of the refundable tax offsets provided to small loss making companies. In our experience, R&amp;D Tax Incentive rebates provided to small companies are mainly, if not exclusively directed toward funding the subsequent year's R&amp;D expenditure. In such circumstances, the R&amp;D Tax Incentive is not only an incentive that encourages additional R&amp;D to be conducted, but its absence would result in a dramatic reduction in the level of R&amp;D than would otherwise take place.</p> <p>Given the increasing globalisation of business activity, including research and development, it is also important that Australia maintains a taxation regime that provides comparable rates of assistance to other countries with whom we compete in attracting international investment in R&amp;D activity. From an international perspective, Australia's fluctuating currency comprises a risk to overseas investors which a favourable R&amp;D taxation incentive regime can at least go some way to redress the competitive disadvantage this risk imposes on research and development location decisions involving Australia.</p>
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<p>40. What other taxation incentives, including changes to existing measures, are appropriate to encourage investment in innovation and entrepreneurship?</p>	
<p>41. What effect is the tax system having on choice of business structure for small businesses?</p>	<p>The current tax system gives too much incentive for small business to use complex structures such as discretionary trusts combined with company beneficiaries. The use of discretionary trusts with an associated company beneficiary requires small businesses and their advisers to have to navigate some of the most complex areas of the Australian tax law including Division 7A of Part III of the ITAA 1936 and the integration of trust law (common law and statute) and the tax law for trust distributions in Division 6 of Part III of the ITAA 1936 and Divisions 115-C and 207-B of the Income Tax Assessment Act 1997 (ITAA 1997).</p> <p>Small businesses use these structures for various reasons but one of the most important reasons is the flexibility it provides for income and capital gains distributions.</p> <p>The small business CGT concessions are also an important factor in deciding which structure for small businesses to use.</p>

42. What other options, such as a flow-through entity (like an S-Corporation), would decrease the overall complexity and costs for small business involved with choosing a business structure? How would such an entity provide a net benefit to small businesses?

We suggest the Government consider introducing a small business entity that could be modelled on (but not the same as) the US S-Corporation. Such an entity could be a corporate but with some tax characteristics of partnerships and trusts. There could be a choice to either flow through income and gains (including the character of the income or gains) or to accumulate profits in the entity at concessional tax rate to reinvest in the business, with franking of subsequent distributions with tax credits for the tax paid by the small business entity. However the relevant provisions should not introduce the profits first rule that was one of the main reasons why the Entity Tax System was not successfully introduced

To ensure small business use this entity instead of the complex trust and corporate beneficiary structures, all (or most) small business tax concessions could be only available through the new small business entity structure.

CGT, income tax and stamp duty rollover relief could be provided to encourage small businesses to convert to using such a small business entity.

<p>43. Is the interaction of the personal and business tax systems a problem? What can be done to manage the personal-business tax interactions?</p>	<p>Taxation of personal income and business income in Australia are generally subject to the same rules i.e. there is not a separate system for personal and business taxation. However, there are particular rules that apply separately for non- business individuals, business individuals and/or companies.</p> <p>Some of these special rules that cause problems in the tax system include:</p> <ul style="list-style-type: none"> <li>• Personal services income rules</li> <li>• Non-commercial loss rules</li> <li>• Small business CGT concessions</li> <li>• Division 7A deemed dividends for loans, payments and debt forgiveness</li> <li>• The new small business company 1.5% tax rate reduction, particularly how that relates to the payment of franked dividends</li> <li>• The new 5% tax rate discount for unincorporated small businesses</li> </ul>
<p>44. What are the most significant drivers of tax law compliance activities and costs for small business?</p>	<p>The most cumbersome parts of the tax law for small business are:</p> <ul style="list-style-type: none"> <li>• Division 7A deemed dividends for loans, payments and debt forgiveness</li> <li>• The CGT small business concessions</li> <li>• The taxation of trust distributions, particularly the complexities of Division 6 ITAA 1936 and Divisions 115C and 207B ITAA 1997</li> </ul>
<p>45. How effective is the current range of tax concessions (such as CGT and industry specific concessions) at supporting small business engagement with the tax system? To what extent do the benefits they provide outweigh the compliance, complexity and revenue costs they introduce?</p>	<p>The small business tax concessions that are most used by small business taxpayers are the small business CGT concessions. While these CGT concessions are useful for small businesses, they are generally only useful at the end of the ownership of the small business. Consideration should be given to reviewing these CGT concessions with the view of providing other concessions at the start or during the life of the small business instead of at the end of the ownership of the small business.</p>

<p>46. What other mechanisms (such as a single lower tax rate, improved technology deployment or other non-tax mechanisms) could assist small businesses to engage with the tax system while decreasing compliance and complexity costs?</p>	
<p>47. Are the current tax arrangements for the NFP sector appropriate? Why or why not?</p>	<p>The tax arrangements of the not-for-profit (NFP) sector have recently been subject to statutory and administrative changes that have resulted in an increased overview of entities with exempt or deductible gift recipient (DGR) status. These changes have has already tightened the requirements for the NFP sector and also heightened the focus by the ATO and the scrutiny by the Australian Charities and Not-for-profits Commission (ACNC) over the NFPs sector.</p> <p>The recent statutory and administrative changes include:</p> <ul style="list-style-type: none"> <li>• Amendments in 2013 to Division 50 ITAA 1997 tightened the tax exemption requirements to include ongoing compliance with all substantive requirements of the entity’s governing rules; and the entity must apply its income and assets solely for the purpose for which the entity is established.</li> <li>• In January 2015 the ATO released TR 2015/1 outlining how it will interpret the requirements of Division 50.</li> <li>• The establishment of the ACNC in 2012 with its role including the monitoring of the ongoing entitlement of a charity to continue to retain its registration and consequently its income tax exemption.</li> </ul> <p>BDO submits that with the greater focus on the regulation of the entitlements by the ATO and monitoring of the charity sector by the ACNC there is increased transparency to society which protects the integrity of the tax concession for the NFP sector.</p>



<p>48. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?</p>	<p>The current FBT concessions provided to NFPs facilitate the recruitment and retention of staff by such NFPs, particularly when competing for such staff against other sectors of the economy. However, BDO considers that the FBT concession does not provide the NFP sector with a competitive advantage but rather may assist the sector in overcoming some of the challenges in retaining staff in the NFP sector.</p> <p><b>Salary sacrificed meal entertainment</b></p> <p>The salary sacrificed meal entertainment and entertainment facility leasing benefits were identified as issues in the 2015 Federal Budget with legislative changes announced to cap the amount and to include in reportable fringe benefits.</p> <p>BDO had previously argued that it considered that it was appropriate that salary sacrificed meal entertainment and entertainment facility leasing benefits were subject to a cap and were reportable. From an administrative perspective only meal entertainment through a salary sacrificed arrangement should be reportable. A broader position to include all meal entertainment would be administratively difficult.</p> <p>For example employees will be involved in entertainment that is part of their duties and this entertainment should be excluded from both the cap and reportable benefits.</p>
<p>49. What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?</p>	

50. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

Given these recent changes to the NFP sector as described in the answer to question 47 above, further changes to the tax arrangements for this sector should be kept to a minimum to allow the new arrangements to work.

The rationale for providing tax concessions to the most charities is that the services supplied by philanthropic institutions replace those that would have to otherwise be supplied by government.

Many activities undertaken by charities / tax exempt entities are not funded by government at any level or are only partly funded. These activities can only be funded by the charities / tax exempt entities from accumulated reserves, sponsorships and fundraising.

A NFP can only source capital from borrowings and accumulated reserves. A NFP does not have a shareholder base that it can go to for capital. Whilst it can ask donors for support for a particular project, the lead time for these is usually substantial and the outcome uncertain. Social enterprise funding is still an unknown source of funds.

The funding of many NFP entities is mainly from two sources being tax deductible contributions and income from investments. If the tax deductibility of donations or tax exemption of investment income was made less concessional, the Government would likely be required to provide the same or similar services.

#### **Tax Deductible donations**

Anecdotal evidence indicates that a major factor in encouraging private and corporate donations is the ability to claim a deduction for that donation. We consider an increase in the threshold of deductibility will provide a disincentive to individuals who cannot donate

more than small amounts (as those donors will not be able to access the concession).

The \$2 threshold allows contact between the DGR and people including those who are not able to donate large amounts. Many small donors become lifetime donors and go on to provide the DGR with considerable donations at a later date and bequests.

Many charities have invested considerable time and resources to establish regular giving programs where a person gives say \$10 per month. These provide a degree of certainty to donation income which historically is fickle.

#### **Refundable Franking Credits**

Certain tax exempt entities are entitled to refundable franking credits on the receipt of franked dividends. The investment of funds that are not required for the immediate day to day requirements of that entity is an important source of funding for many such tax exempt entities.

Where the investment is in dividend paying company shares, the refund of imputation credits is treated as part of the return when considering the balance of return and risk of equities compared to fixed interest.

If the right to a refund of the credits was removed, the investment equity between share investments and fixed interest investments would diminish and there could be a migration away from equity markets.

If tax exempt entities retain all of their available funds in fixed interest investments only, there is a risk that the purchasing power of those funds will be eroded. This would result in a lesser amount being available to the tax exempt entity to devote to its objects.

In addition, we understand that some tax

	<p>exempt charities are able to fund their administration costs from returns on equity investments, including franking credit refunds. This allows those charities to use 100% of their donations for charitable works. This is a good promotion point to attract donors i.e. “100% of your donation will be used for the charitable work of the charity”.</p> <p>Access to the concession is controlled by the ATO and is subject to the controls through Division 50 as outlined above.</p>
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<p>51. 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?</p>	<p>The GST is generally efficient and equitable without too many complexities. It also generally does not discourage business activity or savings because it is generally ultimately only taxed to the end consumer of the goods or services (financial supplies excepted).</p> <p>Therefore it is a tax that could be better utilised and used as a replacement for some other taxes that are not so efficient, simple and equitable.</p> <p>The rate of GST is low compared to most other countries that have similar valued added taxes. Also the current base of the GST is limited by having exemptions for fresh food health and education.</p> <p>There is potential to utilise the GST more appropriately by either or both increasing the rate or broadening the base of the GST. Such increase in the base and/or rate of the GST could be used to fund removal of inefficient taxes, such as state stamp duties and a decrease in the company tax rate.</p> <p>Unfortunately the ability to change the GST rate or base is severely limited by the agreement the Federal Government has with the state governments not to change the GST without unanimous support of all the states. This makes any changes to the GST very difficult if not virtually impossible to achieve.</p> <p>The Federal Government should reconsider this agreement with the state governments with the view to make changes to the GST easier to achieve.</p>
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<p>52. 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?</p>	<p>Many of the state taxes are the ones in most need of reform and therefore the State Governments need to be actively brought into the tax reform debate.</p> <p>The state tax that is most in need of reform or abolishment is stamp duty. Stamp duty is an anachronistic tax that is inefficient, and inequitable. Alternative revenue sources for state governments could be in the form of one or more of the following</p> <ul style="list-style-type: none"><li>• Increase the GST rate</li><li>• Broaden the GST base to include fresh food, health and/or education</li><li>• Broaden the base of Land tax to include principal place of residence and primary production land ( with reduced rates)</li></ul> <p>Payroll tax should also be considered for abolition as it is a direct disincentive to employment.</p>
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<p>53. 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?</p>	<p>The vertical fiscal imbalance for state government revenue causes an imbalance between the states revenue collection and expenditure. This results in the states not taking responsibility for their revenue and causes revenue/expenditure mismatch.</p> <p>The States need to take responsibility for collecting their own revenues to ensure they are making appropriate decisions about their budget revenues and expenditures. Currently the states have no control over one of the biggest parts of their revenue base being the GST.</p> <p>As discussed above at the answer to question 51, it is currently almost impossible to make substantive changes to the GST, which entrenches the vertical fiscal imbalance.</p> <p>An alternative could be to allow the states to change the GST rate and or base as it is applied in their particular states. This may reduce the vertical fiscal imbalance. However, we understand this could also be unconstitutional based on the requirements of section 92 of the Australian Constitution, which requires “<i>the imposition of uniform duties of customs, trade, commerce, and intercourse among the States...</i>”.</p> <p>This means that fixing vertical fiscal imbalance would be very difficult under the current funding model that provides a uniform GST system that is collected and administered by the Federal Government.</p> <p>An alternative that could deal with the vertical fiscal imbalance could be for the GST to be used to fund the Federal Government and the states be then allowed to impose an income tax on their residents (with a resulting appropriate decrease in Federal income tax).</p> <p>If there is still a requirement to provide extra funds to particular State Governments that are</p>
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	<p>undergoing temporary hardships this could be done through a separate Federal Grant funding. If a state needs continual extra funding, consideration should be given to the ability for Federal intervention to either restructure the state finances or to encourage amalgamation with other states.</p>
<p>54. To what extent does Australia have the appropriate mix of taxes on specific goods and services? What changes, if any, could improve this mix?</p>	
<p>55. To what extent are the tax settings (i.e. the rates and bases and the administration) for each of these indirect taxes appropriate? 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?</p>	<p>Refer response to question 52 above.</p>
<p>56. What parts of Australia’s tax system, and which groups of taxpayers, are most affected by complexity? What are the main causes of complexity?</p>	
<p>57. Would there be benefit in developing an Australian metric for tax complexity? What factors should be included? How should they be combined into a metric?</p>	
<p>58. 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?</p>	
<p>59. 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?</p>	



<p>60. 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?</p>	
<p>61. 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?</p>	
<p>62. Would there be benefits in integrating the administration of taxes across the Federation? If so, what would be required to realise these benefits?</p>	<p>See response to question 1 above</p>
<p>63. What changes could be made to provide greater certainty, transparency and accountability to tax policy development in Australia?</p>	
<p>64. Are current tax review arrangements appropriate? How could they be improved?</p>	
<p>65. Could the arrangements for developing tax policy in Australia be improved? If so, how?</p>	
<p>66. Would the benefits of releasing more tax data and detail around costings outweigh the costs?</p>	