



# ACCI POLICY STATEMENT

## TAXATION POLICY

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### INTRODUCTION

Over the course of Australia's history, the development of our taxation system has been as broad reaching and as profound as the transformation that has taken place in Australia's society and economic structure.

Growing out of a simple system of customs and excise duties designed to raise funds for rudimentary social spending, taxation now touches virtually every aspect of our private and business lives. Featured prominently within the overall tax system are Australia's income tax, state taxes, capital gains tax, taxes on goods and services and retirement incomes taxes.

In recent times, policy makers have become more aware of the benefits of competition, efficiency, globalisation, skills development, research and development, investment and education for the economy. Tax policy should provide an environment that encourages each to flourish. Economies that stagnate will be unable to maintain the living standards of contemporary and future generations. ACCI's taxation reforms create the incentives and structure that will deliver economic security and prosperity for all Australians.

In the next ten years Australia's economy will be particularly exposed to the effects of intergenerational change. Australia's future economic fortunes and wealth of its people will, in part, be determined by the decisions and actions taken today in reforming Australia's taxation system.

Current policy makers should respond to these challenges through the creation of an efficient, simple and equitable tax regime. This will build a strong foundation for productivity and economic growth.

### PRINCIPLES OF TAXATION POLICY

Australia needs a tax system that supports the achievement of agreed economic and social principles. Australia's competitiveness should be assisted, not harmed, by the tax system.

Tax revenue should be adequate to meet elected governments' reasonable expenditure needs, consistent with the exercise of fiscal responsibility principles. The tax system should be such that all taxpayers feel confident and satisfied in complying with it.

A sustainable tax structure will only be achieved through an integrated package of reform across all significant Commonwealth and State tax bases in the form of a balanced package covering consumption, income and assets.

ACCI is calling for fundamental reform of Australia's taxation system consistent with the following objectives:

- equity – there should be fairness in the distribution of resources between high and low income people as well as similar tax burdens for taxpayers with similar resources;
- economic efficiency – taxation should impact neutrally on the economy and commercial decisions must not be skewed by tax considerations. The tax system should improve the competitiveness of Australia by encouraging productive investment, risk taking and economic growth and attracting capital and skilled labour;

- adequacy – tax systems should raise sufficient revenue for public expenditure needs, be sustainable in the long run and be consistent with fiscal responsibility;
- simplicity – taxpayers being able to clearly understand and meet their obligations;
- transparency – taxpayers should understand how and when they are paying tax and how much tax they are paying. Hidden taxes should be minimised;
- limit costs – compliance and collection costs should be minimised;
- limit evasion and avoidance – there should be minimum incentive and potential for evasion and avoidance of taxation;
- consistency – tax policy should be internally consistent and consistent with broader Government policies;
- flexibility – the tax system should be able to respond to developments in the economy and society, for example demographic changes, financial innovation, globalisation and the internet; and
- public perception – there should be the widest possible public support for the tax system.

## POLICY OBJECTIVES

Australia's economy has become more dynamic, efficient and productive over recent decades. However, the tax system has only adapted slowly to these changes. As a result, taxes have been a brake on Australia achieving its full potential and being as internationally competitive as it can be. These problems will continue and grow into the future, particularly as globalisation increases and major demographic changes occur.

While changes over the past ten years to Australia's taxation regime have improved equity, sustainability and efficiency, there is still much more room for improvement.

Based on the tax design principles above, the main reasons for further reform of Australia's tax system include:

- improving the efficiency and international competitiveness of the Australian economy;
- continuing Australia's strong growth and productivity results;
- ensuring Australia can meet long-term challenges, particularly demographic changes, in the most cost effective way;
- promoting innovation, risk taking and entrepreneurship;
- encouraging investment in human capital, for example through education and training;
- encouraging skilled migration and the retention of skilled people; and
- reducing tax avoidance and evasion, to improve the perceived and actual fairness of the tax system.

The ageing of Australia's population will become one of the great economic challenges faced by policy makers. Australia's ageing population will lower the supply of labour while placing significant fiscal pressure on Government budgets. The choices faced by Government include: borrowing to fund the health and retirement services; raising taxation on those who remain in the workforce; reducing the benefits for those who are retired; or implementing taxation policies that promote growth and encourage participation.

Of all the choices available, the Government should undertake the strong pro-growth path. The alternatives, such as raising the average tax rate and deferring the tax burden to future generations, will reduce growth, create higher unemployment and reinforce the problems inherent in the current system. Therefore, they are not sustainable in the long-term.

Some policies to increase Australia's growth include: reducing taxation of savings; increasing incentives to invest; reducing the compliance and administration costs on business; and stimulating the supply-side of the economy by providing better incentives for people to enter the labour market.

Higher rates of growth, in productivity and labour market participation will not be achieved by raising taxes or debt. The benefits of successful tax reform are clear. With higher productivity, participation rates and growth, future generations and governments will benefit from our decisions today. The improved growth path will provide tax revenues to fund the necessary services for an ageing population.

The case for tax reform is highlighted by ACCI's 2004 Pre-Election Survey of almost 1700 businesses, showing that tax issues were the first, second, fourth and fifth highest concerns of business.

## **POLICY FRAMEWORK**

All the taxation matters raised below are of importance. Nevertheless, the ACCI membership has identified the following issues to be of primary importance for reform:

- tax compliance;
- personal income tax;
- reforming state taxation;
- capital gains tax; and
- retirement incomes tax issues.

The following proposals are put forward by ACCI for implementation by governments over a ten year period.

### **Tax Compliance Issues: Improving the Processes**

Business is very concerned with the costs of complying with the tax system. The problem is not so much with any individual tax, but the cumulative effect of many individual taxes imposed on businesses. A number of surveys of business show that taxation is consistently a major problem for all businesses. For example, ACCI's 2004 Pre-Election Survey showed that the complexity of the tax system was the second highest concern of businesses, after the level of taxation. Frequency of changes was the fifth greatest concern.

Taxation complexity and compliance represent a drain on the time and finances of all businesses, particularly small business. Any long-term solution is to not only simplify the current system but also to recognise that new legislation must be carefully assessed for its compliance impact.

ACCI proposes that the Australian Government should consider introducing a Tax Administration Impact Statement (the TAIS) to be administered by the Inspector General of Taxation. In introducing the TAIS:

- the Inspector General should undertake a survey of the time and money that business spends on complying with the Tax Act;
- the Inspector General, in conjunction with the Australian Taxation Office (ATO), should introduce a range of

initiatives to assist business to identify, understand and implement new and existing taxation requirements. Information programs for small business in particular should involve all components of the small business network;

- the Inspector General should include within the TAIS a requirement that quantitative estimates of compliance costs, based on detailed proposals for implementation and administration, be attached to any new tax proposal;
- there should also be regular reviews of the accuracy of compliance estimates in the TAIS for regulations with a major impact on business;
- the Inspector General, in conjunction with the ATO, should regularly review its taxation impact assessment arrangements to ensure that they meet best practice standards with regards to minimising the compliance burden on business. International best practice should be continuously introduced into Australia;
- the Inspector General, in conjunction with the ATO, should develop a consistent methodology for measuring the tax compliance burdens imposed; and
- greater education, skill development, resources and priority within agencies is needed. The Inspector General, in conjunction with the Commissioner of Taxation, needs to address the corporate culture within the ATO to ensure that the TAIS is carefully constructed when each new tax change is proposed.

ACCI also recommends that the Treasury should establish a committee similar to the Corporate Consultative Committee at the ATO which has the aim of tapping into business concerns and experience in the development of tax legislation and its administrative arrangements.

## Personal Income Tax

Personal income tax directly affects nearly all households and businesses and should therefore be recognised as a crucial determinant of economic success.

However, Australia's income tax regime does not meet the tax reform objectives outlined earlier. It is too punitive by international standards, reducing the incentives to work and accumulate human capital. It discourages innovation and skilled migration, while encouraging harmful tax minimisation and the departure of people from the workforce. The need for reform is exacerbated by changing demographics and greater international competition for skilled workers. Business is very aware of this issue – ACCI's 2004 Pre-Election Survey showed that personal tax was the fourth highest concern of all business. It is the largest concern for small business.

Even with recent changes, the current system has both high marginal tax rates and low thresholds to which marginal tax rates apply. There is a significant wedge between the company tax rate and the income tax, which encourages tax avoidance. Addressing these issues is a priority.

In summary, ACCI proposes that the Government should:

- implement, as a first step, the original tax schedule proposed at the time of the introduction of the GST (appropriately adjusted for inflation);
- ensure the elimination of bracket creep via the indexation of taxation thresholds;
- gradually reduce the top marginal rate to the same level as the corporate rate;
- over a longer period seek to reduce the number of tax thresholds to the minimum number possible and preferably no more than two; and

- decrease the taxation on savings income and reintroduce the 15 per cent tax rebate on savings.

## Reforming State Taxation

State taxation issues, in particular payroll tax, are amongst the most important of the tax issues facing business. State taxes are levied in an ad hoc manner with different rates, exemptions and definitions applying in different States to economically identical transactions and assets. As a result, compliance costs are raised for businesses that operate across multiple jurisdictions and resources are reallocated away from those areas where most economic advantage would accrue.

Payroll tax is a general-purpose state tax levied on employee remuneration, at different rates, depending on the jurisdiction. Changes to reduce both its complexity and burden are necessary if Australian businesses are to remain competitive.

While some reform to state taxes has taken place following the 1999 Intergovernmental Agreement (IGA) on the Reform of Commonwealth-State Financial Relations, a renewed commitment to further reform is necessary.

ACCI is proposing:

- as a matter of priority, the full implementation of changes included in the 1999 IGA – namely the abolition of:
  - Bank Account Debits Tax;
  - stamp duties on non-residential conveyances;
  - stamp duties on non-quotable marketable securities;
  - stamp duties on leases;
  - stamp duties on mortgages, bonds, debentures and other loan securities;
  - stamp duties on credit arrangements, instalment purchase arrangements and rental arrangements; and
  - stamp duty on cheques, bills of exchange and promissory notes.
- where possible State and Territories should undertake expenditure restraint to reduce the level of inefficient taxes such as any remaining stamp duties;
- reform of the Fire Insurance Levy so that it is based on property values and applies to all property. The current system in NSW and Victoria, which places a levy on insurance premiums, is unfair and unnecessarily complex; and
- the States should implement major reductions in payroll tax as a first step towards its eventual abolition. This could be achieved by handing the tax back to the Australian Government.

For the purposes of this policy, ACCI has assumed that the roles and responsibilities of State and Federal Government in the provision of services remains the same.

## Capital Gains Tax

A capital gains tax (CGT) is applied to the increase in asset value when an asset is sold.

While the Australian Government substantially reduced CGT with reforms in 1999, other countries such as the UK and the US have since implemented CGT changes to attract greater investment. Australia's CGT system is no longer competitive with these countries and is limiting the potential investment in research and development and in innovation.

Therefore, it is necessary to revisit some of the alternative methods canvassed by the 1999 Ralph Review of Business Taxation but not accepted by the Government on the grounds of revenue neutrality.

ACCI proposes:

- that the Australian Government should seriously consider introducing a stepped rate capital gains tax to significantly reduce the burden of tax on capital gains and encourage increased investment (a possible stepped rate schedule is reproduced in Figure 1); and
- that the carry-back of capital losses, an extension of rollover provisions and franking credits for capital gains should be considered by the Australian Government.

**Figure 1**  
**A Possible Stepped-Rate Capital Gains Tax Schedule**

<b>Time Asset Held</b>	<b>Proportion of Capital Gains Subject to Tax</b>
Less than 1 year	100%
1-2 years	50% (25% for small business with underlying active asset)
2-5 years	25%
5-10 years	10%
More than 10 years	0% (ie tax free)

## Retirement Incomes and Superannuation Tax

The proportion of the population eligible to receive the Age Pension will double over the next forty years, putting immense pressure on our tax system. Therefore, the Australian Government must continue to develop policies to encourage people to save more money for their retirement.

ACCI proposes:

- that the present taxation of superannuation contributions and earnings should be abolished and gradually replaced with equivalent levels of taxation at the point of benefit only;
- any increase in the Superannuation Guarantee should be made through the introduction of employee contributions rather than further demands on already over-burdened employers; and
- a 15 per cent tax rebate on savings should be reintroduced to encourage higher personal superannuation contributions. The rebate could be claimed for super contributions up to \$3,000.

## Corporate Philanthropy and Tax (Increasing Education and Training Investment)

Governments provide support for many socially worthwhile services. Many businesses choose to support these services as well. For example, companies donate money to charities, schools, universities and artistic institutions.

Without business philanthropy, the costs to Government would increase substantially or many services would have to be cut back.

Therefore, it is time to consider tax incentives to increase corporate philanthropy and support community and business partnerships. In particular, incentives for education will promote investment in human capital and therefore increase economic growth.

ACCI proposes:

- the continuation of tax incentives to increase general corporate philanthropy and support community and business partnerships;
- the Government should seriously investigate a package of measures which improve the level of donations and bequests to Australian universities; and
- the Government should also examine the possibility of introducing tax incentives to increase the level of investment by employers and individuals in other education and training activity.

### Employee Share Ownership Plans

Providing employees with a share in ownership can play an important role in improving productivity and changing the nature of employer/employee relationships. Over the years, however, this has not been seen as a mainstream issue and these plans remain largely confined to the executive remuneration sector.

The issue was examined in a House of Representatives Standing Committee inquiry which reported in 2000 (called *Shared Endeavours: An Inquiry Into Employee Share Ownership*) and made a number of recommendations which were not subsequently accepted by the Australian Government.

ACCI proposes that Australian Government should give serious consideration to implementing all of the taxation recommendations arising out of this Report.

### Fringe Benefits Tax

Fringe benefits are non-cash benefits provided by an employer to an employee instead of salary. Examples can include a car, computer, insurance, accommodation and meals.

Fringe Benefits Tax (FBT) was introduced in 1986 to bring non-salary benefits paid to workers by their employers into the income tax system.

Regrettably, the tax has been extended well beyond its original purpose of ensuring consistent taxation of all forms of remuneration and has added substantially to the costs of doing business.

ACCI proposes that:

- like all other income, FBT should be applied to the employee, with collection from employers in the same manner as the Pay As You Go system;
- the application of FBT to allowances paid for employment in remote areas and certain costs relating to relocation are counter-productive to other economic and social objectives in Australia's industrial development;
- on compliance:
  - the FBT treatment of business meals should be examined and reformed to reduce compliance costs significantly;
  - some form of optional standard rates for car parking could apply for a year or part year, provided that the rates are set in an equitable and realistic manner; and
  - employee declarations should be replaced by allowing senior managers to provide authorisation, based on sighting of required information.

- the FBT law should be based on a ‘remuneration test’ in the definition of fringe benefits; and
- the Government should look at extending the FBT exemption on childcare.

## Infrastructure and Taxation

In the past, it was thought that Government should be involved in most if not all infrastructure development. In recent years however this paradigm has shifted and the private sector is now playing a greater role in many infrastructure developments. This has reduced the pressure on Government budgets and has enabled improved efficiency of infrastructure building and operation.

To ensure that the private sector investment in infrastructure is not penalised, ACCI is calling for provisions in the Income Tax Assessment Act that discourage private sector investment in infrastructure to be amended.

In particular, Section 51AD and Division 16D of the Income Tax Assessment Act should be reformed as they impede investment in infrastructure.

## Research and Development Tax Concession

It is generally recognised that Research and Development (R&D) is an important driver of economic growth. Therefore, Government intervention to promote R&D is justified to the extent that this promotes efficiency, productivity and growth.

Since 1985, the Government has provided tax incentives to R&D, particularly through the R&D Tax Concession. Business has supported the R&D tax concession as an effective policy instrument addressing a market failure.

The OECD has estimated that innovation accounts for 50 per cent of long term economic growth in advanced industrial countries.

In 1996, the Australian Government reduced the Concession from 150 per cent to 125 per cent which, together with the reduction of the corporate tax rate, has seen the value of the tax benefit decline considerably and had a significant impact on business R&D expenditure.

An effective R&D tax concession that promotes greater investment in R&D is a crucial element of our national innovation system.

ACCI proposes that:

- the R&D Tax Concession should be restored to 150 per cent; and
- the Government should introduce a specific 175 per cent tax concession on greenhouse-related R&D.

## Tax Credits and the Welfare System

An ever increasing proportion of the Australian population depend upon welfare as their sole or major source of income. As a result, the public policy debate has often focused on the capacity of the income support system to encourage the transition from welfare dependency to paid employment.

This transition is not helped by the interaction of welfare payments criteria and the personal income tax system, which can give rise to high effective marginal tax rates (EMTRs) for low-income earners. As welfare beneficiaries take up paid employment, they lose income supplements and begin to pay tax on earned income. The combined effect can severely impair incentives to participate in the workforce, especially for sole parents and families with children.

ACCI proposes that:

- an earned income tax credit warrants further consideration. It is an option that can potentially increase work incentive and raise the disposable incomes of low-income families;
- the 1998 *Five Economists' Proposal*, seeking to trade off tax cuts for a pause in minimum wage growth, should not be implemented, as it is a variation of the *Prices and Incomes Accord* of the 1980s; and
- the solution to unemployment does not lie in the tax system alone. The solution lies in reforming the industrial relations system and in labour market programs to re-skill the unemployed, as well as removing incentives to remain on welfare for extended periods.

## International Taxation

Australia is a medium sized open economy and needs to participate extensively in the world economy to maintain and improve our standard of living. Australia's international tax system is a vital component in ensuring we remain competitive in a globalised environment where international investment flows become more important. Tax policy particularly needs to ensure that Australian businesses are not prevented from developing and employing the best business structures, finance, people or opportunities available.

The increasing relevance to Australia of foreign direct investment (FDI) has generally not been reflected in changes to the tax system. If Australia is to engage in a more globalised world economy then such changes need to take place as soon as possible.

ACCI proposes that:

- domestic shareholder tax relief should be provided for unfranked dividends paid out of foreign source income but the amount of relief must be carefully chosen; and
- substantial reductions in personal taxes are needed to ensure that Australia enhances its international competitiveness for skilled workers.

## Regional Business Development and Taxation

ACCI has actively advocated the need for government to focus on investment and business development as the key drivers for regional development and welcomed the release of a *Regional Business Action Plan* in 2003.

ACCI supports a number of tax policy proposals from the Action Plan and proposes that:

- the rate of depreciation on certain assets should be accelerated where there is a significant difference between the construction cost and salvage value;
- the Zone Tax Rebate boundaries be aligned with the ABS definitions of remote and very remote; and
- the Government should remove eligibility for the Zone Tax Rebate from those people who are employed under fly in/fly out arrangements and whose principal place of residence is not in one of the designated zones.

## Indirect Taxation

Indirect taxes apply to the consumption of goods. There are a number of indirect taxes including the Goods and Services Tax (GST), excise on alcohol, tobacco and petroleum products and a number of levies (such as the sugar levy, Ansett levy and milk levy). The majority of excise revenue is collected from petroleum and other fuel products such as biodiesel,

ethanol and fuel oils, which accounts for 75 per cent of all excise taxes collected.

The GST, which came into effect in 2000, largely replaced the narrowly-based, cascading and inequitable Wholesales Sales Tax (WST) as a major source of government revenue. The GST was originally envisaged to cover a wider range of goods, which would have made it simpler to apply and raised sufficient revenue to eliminate a number of more burdensome state taxes sooner. However, the GST exemptions were increased to secure the passage of the enabling legislation through Parliament.

Suggestions have been made that the GST base could be expanded or the rate increased to fund the removal of other taxes. ACCI opposes these proposals. Business was supportive of the GST legislation because it included a series of safeguards that have made increases in the rate and extensions of the base difficult. This remains true today.

ACCI proposes that:

- there should not be any increase in the GST rate or extension of the base; and
- there should be continued reform of the administration of the GST system as issues arise.

## Company Taxation

The company tax regime has recently been subject to major reforms that have enhanced Australia's attractiveness as a regional business headquarters and will ensure our continuing competitiveness in the global economy. At the core of these changes has been a reduction in the rate of company tax to 30 per cent, which is more competitive with other countries across the globe – although many other countries have been reducing their company tax rates in recent years as well.

ACCI:

- proposes that, while reducing company tax is not something that should be ruled out in the future, the immediate priority is to reduce the top personal income tax rate down to the current corporate tax rate of 30 per cent before further reductions in company tax are contemplated; and
- agrees in principle to the concept of equal treatment in the taxation of different business entities but based on previous experience, we are sceptical that a workable, simple and efficient model can be implemented without significant transitional costs.

## Budget Context

ACCI believes it is vital to create a tax system more encouraging of innovation, investment, participation, skills development and growth. Therefore, governments should undertake continuous efforts to implement the proposals in ACCI's taxation reform policy over the coming decade. Business understands that governments have competing agendas and objectives over the allocation of resources. However, the policy should fit into the Government's overall policy objectives and budgetary position.

ACCI's taxation reform policy can be funded over the next ten years through either reductions in government expenditure or drawing down budget surpluses. ACCI maintains that it is important for the Government to maintain the overall objective of maintaining budget balance over the course of the business cycle. Therefore, Government funding for the policy would be subject to macroeconomic circumstances. During times of large budget surpluses the government must undertake to implement a number of reforms simultaneously.

All the taxation matters raised are of importance. Nevertheless, ACCI's membership has identified the following areas as needing priority reform:

- tax compliance;
- personal income tax;
- state taxation;
- capital gains tax; and
- retirement income tax.

The cost of ACCI's proposed taxation policies, excluding personal taxation, would be less than \$4 billion per annum. The cost of personal tax changes could rise to as high as an additional \$10 billion.

While this is a lot of money, relative to projected budget surpluses for the near future, it is not excessive. For example, the latest Treasury forecasts for the Budget surplus (the projected underlying cash balances as at September 2004) are \$5.3 billion in 2004-05; \$5.1 billion in 2005-06; \$6.9 billion in 2006-07 and \$7.9 billion in 2007-08.

The effect of a tax cut of \$14 billion to the budget over a ten year period would be to reduce total taxation revenues from approximately 32 per cent of Gross Domestic Product (GDP) to 30 per cent of GDP. Further, if in the longer run the abolition of payroll tax were added to the list and it was also funded by expenditure restraint that would see revenues as a share of GDP fall to around 29 per cent. This would place Australia closer to the US in terms of total taxation as a percentage of GDP.

## CONCLUSION

The time is right for Australia to make meaningful reform to its taxation system. Recently the government has been able to maintain surpluses as the economy experiences a long period of economic growth. These surpluses could be used to provide substantial reforms. However, over time demographic changes will reduce the available funds for reforms.

As global economies become more interdependent and as the movement of capital and skills becomes more fluid, Australia must create a system of taxation that allows a small, open economy to compete internationally. By advancing skills development and investing in capital deepening, the welfare of Australians both now and in the future will be secure.

The next ten years of tax reform is pivotal to the next twenty years of economic development.

At this moment Australia is in good shape to take advantage of current events and secure its future but opportunity will not last forever.

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