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AFTS Secretariat
The Treasury
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Dear Sirs

Review of Australia's Future Tax System (AFTS)

The Group of 100 (G100) is an organisation of Chief Financial Officers (CFOs) from Australia's largest business enterprises with a purpose of advancing Australia's financial competitiveness.

The G100 welcomes the Government's initiative to conduct a review of the Tax System with a view to making substantive and long lasting reforms and is pleased to respond to the request for comments. This submission can be made public.

The G100 would welcome the opportunity to meet with the AFTS Panel to discuss our views.

DETAILED SUBMISSION

The G100 is vitally interested in the design of Australia's Future Tax System as it impacts on the growth and efficiency of the Australian economy including the well-being of Australia's large businesses, their employees, customers, suppliers as well as shareholders and other stakeholders.

As a small capital attracting country, Australia needs a Tax System that maximises efficiencies in both attracting investment capital and developing and utilising the skills of its small and ageing workforce population.

As a result, the Tax System should encourage:

- investment in both labour and energy efficient capital equipment and infrastructure to achieve and sustain productivity growth;
- a globally competitive cost of capital for business investment;
- research and development and innovation;
- an increasingly higher quality of labour resource through education and training and the development of high value intellectual property skills;
- greater levels of community savings as well as related increases in capital and borrowing liquidity;
- the reduction of carbon pollution and other adverse impacts on the environment; and
- productivity and revenue growth dividends through tax policy revision and recalibration through ongoing Legislative and Revenue Administrative reforms.

The G100 believes that the following three key principles are critical to the ongoing framework of our Tax System. These three principles are:

1. International Competitiveness;
2. Simplicity and Certainty; and
3. Robust Governance of ATO and alignment with Investment Policy Objectives.

Applying these three principles, we believe that the current policy objectives and related initiatives that are appropriate for our Tax System can be outlined as follows.

1. INTERNATIONAL COMPETITIVENESS

1.1 Australia needs a globally competitive tax rate on income from capital by reference to real effective rates levied on income from capital – not just "headline" rates.

This will encompass not only a globally competitive corporate statutory rate by OECD standards, but will also need to factor in the level of taxation applicable as profits flow through the system to the ultimate providers of capital, including income and withholding taxes on both equity and debt providers.

An imputation system or a regime which taxes dividend income at a lower rate than that which applies to other income is important to avoid the double taxation of business profits. In either case, the system adopted should be calibrated as best as possible to avoid the imputation distortions such as those that apply to low distributing entities, non-resident owned businesses as well as the bias against foreign sourced income.

Although Australia and New Zealand are countries that have a true imputation system, there is evidence that other countries have adopted different mechanisms to alleviate the impact of the double taxation of business profits as applies under a classical system of taxation. (For example, the United Kingdom removed its ACT regime and replaced it with a broad credit for dividends paid).

A global trend is to tax income from capital increasingly at lower rates in order to attract capital. The sources of global capital are constantly changing and are increasingly located in lower tax countries (e.g. sovereign funds, resource rich jurisdictions, etc.) and, as a consequence, are now more sensitive to tax imposts than previously.

For a small capital attracting country like Australia, our tax system should be designed to attract capital and avoid being an impediment to accessing global capital flows.

In this context, withholding taxes and other imposts on cross-border sources of capital (both debt and equity) should be reduced or eliminated. Companies and financial institutions should have ready access to offshore capital flows without having to bear the tax imposts of raising such capital. In the case of a small country like Australia, these imposts are invariably borne by the users of capital rather than the providers.

1.2 Skilled labour has become increasingly mobile in a globalised economy. Moreover, Australia is facing shortages of skilled labour due, in part, to its ageing population.

As a result, the tax regime should be calibrated to ensure that:

a. **there are as few barriers as possible to encouraging the migration of skilled labour to Australia;**

b. **workforce participation rates are increased by encouraging otherwise non-working spouses to join or rejoin the workforce; and**

c. **those who would otherwise retire be encouraged to remain in the workforce longer.**

This requires close consideration of effective marginal tax rates on those affected as well as reconsidering implied tax incentives that make it attractive for people to leave the workforce at certain stages of their careers, (e.g. age thresholds inherent in the superannuation system) and the tax treatment of temporary residents, or returning residents, to ensure barriers to entry are minimal.

1.3 Australia should remove any distortions, and provide incentives such as accelerated depreciation or investment allowances, to encourage investment in more productive plant and infrastructure, including more energy efficient and less carbon or other polluting assets.

As a result of reducing the corporate tax rate from 36% to 30% during the previous Government's Ralph Tax Reforms, accelerated depreciation rates were repealed. This change was followed by an ATO review of the effective lives of plant and equipment which had the effect of increasing such lives, exacerbating the problems encountered by businesses that invest in depreciable (hard) assets.

Australia has made significant progress in achieving productivity gains over recent years, much of which has resulted from individuals working longer hours. However, future productivity gains are less likely to come from a further increase in working hours, and are more likely to come from the use of modern and more productive capital and infrastructure.

The Tax System must be calibrated to facilitate the capital investment needed. The growth dividend that results from such capital investment will contribute

towards offsetting the costs of any concessions to business owners to modernise their capital stock.

1.4 Australia should remove distortions that discourage investment in intellectual property assets such as certain intangible assets and business goodwill.

Unlike the United States and the United Kingdom, Australia does not provide tax deductibility for business goodwill and certain other forms of intangible assets.

For example, investments in customer lists, secret processes, operational models and other types of "soft" intangibles are not treated equally compared to the acquisition of hard assets. Moreover, in a fast moving globalised world, the amortisation of patents, trade marks and copyrights may no longer match the revenue stream such assets produce.

A modern 21st century tax regime should not contain such distortions. This is especially so for Australia where the development of intellectual property and related skills must form an important part of our future prosperity. Aligned with this is the need to continue to provide incentives to encourage further investment in research and development and innovation initiatives. These initiatives, if successful, give rise to intangible assets of the kind in question.

Whilst the Government has initiated the Cutler Review to provide input on the reform of the tax R&D incentive, there still remains a disconnect in our tax system between how it deals with intangible assets once they are created and then sought to be sold or exploited. The review should consider the tax treatment of such intangible assets and seek to remove any disincentives to investment.

1.5 Australia needs to make it easier for local businesses to tap into both domestic and foreign suppliers of capital by increasing the pool of community savings available and reducing tax imposts on such capital flows.

Australia should:

a. continue to encourage residents to save through the superannuation system as well as other means (e.g. increased deposits at banks); and

b. encourage non-residents to increase the deposit base of local financial institutions so that overall there continues to be large savings pools from which both financial institutions and Australian businesses can source competitive funding needs.

Local businesses should be able to readily access foreign providers of both debt and equity capital by having fewer tax imposts (such as withholding taxes) levied on such fund flows.

1.6 There should be One National Tax Authority to administer and collect both Federal and State taxes.

A single national authority will help ensure efficiencies of scale, removal of much 'deadweight' cost, as well as assist with the national harmonisation of currently disparate State tax laws and Federal versus State business rollover and reconstructions reliefs.

The Treasury Architecture Paper released in August 2008 makes reference to the fact that there are currently over 120 taxes in Australia but that 90% of tax revenues are collected from the top 10 taxes.

There is no comprehensive overlap between the rollover or business reconstruction reliefs available under the Federal tax regime and those available under the State regimes. Accordingly, the costs of compliance for a national business are more onerous than they need be, particularly where businesses seek to restructure to achieve improvements in efficiency but are impeded in doing so by the lack of harmonisation of tax laws across State and Federal jurisdictions. Additionally, the various State bodies, even when administering the same type of State tax, have different interpretative and administrative practices as well as compliance requirements.

We strongly recommend that:

a. all Federal and State taxes be collected and administered by the one coordinated tax authority with the purpose of harmonising the laws

across States making them consistent with Federal income tax laws, and to achieve improvements in compliance and administrative efficiencies; and

b. the rules be harmonised to enable national businesses to operate seamlessly and achieve operating and structural improvements without costly or prohibitive tax impediments.

1.7 We believe that there should be fewer taxes nationally and that some State taxes may be able to be abolished even if this requires increases in selected remaining taxes to, in part, accommodate for the loss of revenue.

In calibrating the respective increases in other selected taxes, secondary impact growth dividends and the removal of 'dead weightcosts' giving rise to efficiency dividends should be taken into account.

For example, the abolition of Payroll Taxes should give rise to significant growth dividends as well as increased Federal tax revenues given that it is currently an allowable deduction for income tax purposes.

1.8 We need to continue with the modernisation of our international tax rules.

We would welcome the Government's early attention to the work being conducted by the Board of Taxation in the area of CFC and FIF reform.

As both large and smaller-sized businesses are increasingly growing offshore – with many smaller businesses these days "born global" - the ongoing modernisation of our international tax regime continues to be of vital importance to Australia's international competitiveness.

2. SIMPLICITY AND CERTAINTY

2.1 We need greater legislative certainty in our taxation laws and this generally comes from increased simplicity in the law.

Certainty needs to be achieved by minimising the constant need to seek tax rulings and by removing the exercise of administrative discretions on the part of the ATO (except for taxpayer relieving discretions).

Companies are today, more than ever, under constant market and regulator pressures to avoid financial misstatements. Tax is one of the most significant areas of uncertainty contributing to potential financial misstatements.

Despite various ongoing attempts to simplify our tax laws in recent years, the tax law remains incredibly complex and unclear. Simplifying the law requires the injection of greater certainty in the law, not simply fewer pages of legislation. Attempts in recent years to reduce the amount of tax legislation, whilst laudable, cannot be considered as having achieved any meaningful improvement without a substantive increase in legislative certainty.

Other examples that are particularly acute in this regard include the uncertainties still surrounding the operation of many business rollovers, including scrip-for-scrip and demerger relief, share buyback arrangements and capital tainting rules.

These rules require urgent attention to remove ATO discretionary input so that their operation is clear without the need for ATO rulings. The rulings should be broadened to better enable restructures to occur within a wider compass of entities and shareholder groups.

The deductibility of interest income, including the debt-equity divide, continues to be problematic for major businesses.

For non-resident investors, the overlap between the thin capitalisation provisions and the transfer pricing provisions has recently become a major problem.

It is also anticipated that the revenue-capital distinction, particularly so for those in the funds management industry, is becoming a problem area due to its uncertainty and the administration of the law historically.

A 21st century modern tax regime for Australia should anticipate these and other areas of uncertainty and incorporate processes to provide legislative responses ahead of the issues emerging and impacting on market-place behaviour.

The review should also consider allowing taxpayers to opt for relying on their financial accounting statements for tax purposes. Recent examples include TOFA and Thin Capitalisation. Whilst consideration of IFRS changes may need to be taken into account as impacting on the tax outcomes, an "opt in or out" choice may alleviate some concerns with improved compliance and simplicity.

Finally, on certain limited occasions, despite these potential improvements, Tax Rulings will continue to be necessary for the sake of absolute certainty. It is important that business has ready access to a speedy and transparent process for obtaining such Rulings, including regular and independent monitoring of such a process for continuous improvement.

2.2 We need to adopt a "materiality" concept to legislative design such that every dollar of revenue is not sought at the expense of ATO as well as business compliance costs.

The tax law should not be written from the perspective of removing loopholes which are exploited by the few. This imposes increased costs of compliance on those taxpayers who do not search for loopholes.

There should be an ongoing review of the amount of tax revenue raised from certain imposts compared to the compliance aspects of those imposts with a view to constantly recalibrating the two so that we avoid taxing immaterial amounts for nil or negative net overall benefit to the community. For example, fringe benefits that are not part of an individual's compensation package should not be taxed. Integrity concerns should be capable of being dealt with by specifically targeted measures or other means.

2.3 There should be an Annual Tax Technical Correction Bill to instil discipline into having an ongoing process of legislative improvement in our tax laws.

Often many of the uncertainties that arise from poor legislative design or drafting are well known for some years before they are acted upon.

The inertia in dealing with these problems often lies in the Government being reluctant to bring forward technical corrections before Parliament for a number of reasons including political considerations.

The discipline of having an Annual Tax Technical Corrections Bill (ATTCB) will force the issue and make the political aspect of this process less influential.

Moreover, the planning process for producing an annual set of technical corrections, with public consultation as part of this process, should identify and rectify problems before they become major problems.

3. ROBUST GOVERNANCE OF ATO AND ALIGNMENT WITH INVESTMENT POLICY OBJECTIVES

3.1 The Australian Taxation Office (ATO) should be subject to a more robust Governance and Oversight model akin to that of public companies who have independent boards. This model should aim to ensure that:

- **the conduct and affairs of the ATO are administered independently of Government revenue raising concerns, or other biases, and that the ATO at all levels administers the Act in a manner consistent with the Government's Investment Policy Objective of encouraging both domestic and foreign investment in Australia; and**
- **there is an appropriately aligned "Tone at the Top" and associated "Code of Conduct" so that all ATO officers and the ATO internal culture are aligned with the above Investment Policy Objectives, including measures to monitor and ensure that all officers are accountable for their conduct and actions; that KPIs covering the above objectives are properly set, reviewed and monitored; and that an appropriate disciplinary regime is implemented.**

Many other countries are facing similar challenges to those confronting Australia and there is strong competition between countries to attract investment dollars. These countries, amongst other things, use their tax systems to do so. Whilst historically, developing countries or countries with little in the way of large workforces or sizeable capital markets did this (e.g. Singapore, Ireland, Hong Kong, China, etc), the more developed countries are now involved (e.g. UK, Germany, US, Canada, etc). *(For example, the US currently allows concessions for certain dividend flows, the UK is considering reforms of its international tax rules, and Canada has reformed its interest withholding tax rules).*

Accordingly, at the same time as investment capital has become increasingly mobile, countries have become much more competitive and readily use tax policy settings to seek to retain and attract it.

Many Governments set tax policies and conduct their national tax affairs in a way that encourages domestic multinational enterprises to remain domiciled and to attract foreign investment dollars in areas that are consistent with Government investment policy objectives. The Australian Government has similar policy objectives of retaining and attracting globally mobile investment capital and, for example, has recently announced its intention to position Australia as a Financial Services Hub.

However, a well designed set of tax policies aimed at attracting and retaining investment capital can be somewhat naïve and become significantly diluted in its effect if the administration of the tax system frustrates business and works contrary to the policy settings.

We believe this occurs in Australia because there is no appropriate Governance framework for the ATO that balances its important revenue collection function with an appropriate "open for business" national policy mindset.

Australia should recognise that an increasingly important investment policy tool is the preparedness of its Institutions and Regulators – and especially the ATO – to have a modern and commercial mindset aligned to Government investment policy objectives.

Although there is no question of the integrity of the ATO or the Commissioner of Taxation, there is a widely held perception within the business community – especially amongst those who deal with the ATO at the coalface – that the ATO is inclined to take the view that typically favours the revenue even though there may be reasonable, or even strong arguments, to the contrary.

Whilst we do not believe that this is due to any direction from the Commissioner, we suspect that it is a cultural attitude that has developed over many years. Moreover, despite the best efforts of the Commissioner to direct

his officers to apply the law without bias to the Revenue, this cultural attitude will be difficult to change in a 'business as usual' environment.

This widespread perception of revenue bias unfortunately has given rise to a sense of distrust of the ATO within the business community and has led to a number of unwarranted consequences including the following:

a. many companies are not willing to rely on their, or their adviser's judgement, on the operation of the law and are therefore inclined to seek rulings or QC opinions on major tax issues thereby increasing the cost of compliance;

b. ATO disputes often extend over many years and are often settled on the grounds of commercial expediency rather than on the perceived correctness of the technical tax position. This results in increased frustration and associated costs for business; and

c. business typically looks for increased legislative certainty rather than reliance on administrative practices or discretions. This gives rise to very prescriptive or complex legislative provisions, as well as a great reluctance to rely on 'principles-based drafting'.

   The concern is that the ATO's enforcement of the 'principles' may differ markedly from the business' perception of how they should be implemented.

The ATO has also been slow to pronounce its views on a number of significant matters with the result that many years may pass from the time the issues become important. This results in increased frustration and associated costs for business.

There are a number of examples where a market practice has developed in respect of particular tax issues which have not been objected to by the ATO. However, subsequently the ATO has pronounced its views in a manner inconsistent with that longstanding market practice. Examples of this include the current distinction between Revenue and Capital in respect of collective investment vehicles, the capitalisation of project-related salary and wage costs, the overlap of the Thin Capitalisation provisions and the Transfer Pricing rules and the tax treatment of copyright assignments for withholding tax purposes. The level of business frustration and related costs of compliance and

management time resulting from these issues has been and will no doubt continue to be significant.

We believe a considered and well structured Governance and Oversight body for the ATO will be able to make meaningful improvements to the way that the ATO administers the tax law, and which will not otherwise be capable in a 'business as usual' environment.

We note that the Government has sought over recent years to change certain aspects of Australian Tax Law administration by creating bodies such as the Board of Taxation and the Inspector General of Taxation. Whilst these efforts are applauded, we believe the fundamental problem lies with the lack of a proper governance and oversight framework of the ATO pursuant to which the Tax Law can be administered.

3.2 There should be a regular benchmarking review, not later than every 4 years, of the global competitiveness and overall efficiency of our Tax System involving public consultation.

It is important that with the intense competition for mobile global resources such as capital and labour, our tax system remains globally competitive on a sustainable basis. This can only be achieved and maintained if it is monitored and calibrated on a regular basis.

As mentioned above, many countries now compete vigorously for mobile resources and use their tax system as an important tool in this battle for resources. In saying so, this does not mean that Australia should participate in an ongoing regular "race to the bottom" in terms of lower tax rates. Rather, we believe that many aspects of our tax system can be recalibrated regularly to ensure it is appropriate for its time and consistent with Government, Social and Investment objectives.

As is evident from the many aspects of the tax system under review in the present exercise, tax rates are only part of the equation and, in some years, it may be necessary to raise certain rates, or change the tax mix.

A Timing Appendix setting out our suggested time frames over a short term (1 to 2 years), medium term (3 to 5 years) and long term (5 years +) horizon is attached.

Should you have any questions or comments, please do not hesitate to contact me at the Group of 100. Should you wish, we would be pleased to discuss these views further with the AFTS Review Panel.

Yours sincerely

Tony Reeves
National President

TIMING APPENDIX

Broad timeframes for implementing G100 Recommendations

		G100 Recommendations	**Time Horizon**		
			Short Term (1-2yrs)	**Medium Term (3-5yrs)**	**Longer Term (5yrs+)**
1.		**International Competitiveness**			
	1.1	Australia needs a globally competitive tax rate on income from capital – encompassing the corporate rate, imputation and lower related income and withholding taxes on providers of both equity and debt capital.	✓		
	1.2	Remove tax barriers to the migration of skilled labour and to encourage non-working spouses and retirees to join the workforce or remain longer in it.	✓		
	1.3	Remove distortions and provide incentives (e.g. accelerated depreciation or investment allowances) to encourage investment in more productive (including more energy and pollution efficient) plant and infrastructure.	✓		
	1.4	Remove distortions that discourage investment in intellectual property assets such as certain intangibles and business goodwill, including increased R&D and Innovation incentives		✓	

		G100 Recommendations	**Time Horizon**		
			Short Term (1-2yrs)	**Medium Term (3-5yrs)**	**Longer Term (5yrs+)**
	1.5	Increase the savings pool from which local businesses can source both debt and equity capital and reduce related tax imposts on such capital flows (including lower taxes on interest)	✓		
	1.6	One National Tax Authority to administer and collect both Federal and State taxes and generate related harmonisation and dead weight cost savings			✓
	1.7	Fewer taxes nationally	✓		
	1.8	Continue with the modernisation of our International Tax Rules	✓		
2.		**Simplicity and Certainty**			
	2.1	Greater legislative certainty including removal of administrative discretions, wider reconstruction relief and optional reliance on IFRS		✓	
	2.2	Adopt a 'Materiality' concept to legislative design		✓	

		G100 Recommendations	Time Horizon		
			Short Term (1-2yrs)	Medium Term (3-5yrs)	Longer Term (5yrs+)
	2.3	Annual Tax Technical Corrections Bill		✓	
3.		**Continual Policy and Administrative Governance Improvement**			
	3.1	Independence and Governance Oversight Framework for the ATO	✓		
	3.2	Regular Benchmarking (no later than every 4 years) of Tax System for Global Competitiveness and efficiency		✓	

OUTCOME

In five years' time:

- Australia's competitive tax regime and high savings pool makes it an attractive destination for foreign investment as well as for Australian-based multinational enterprises to do business; and
- Australia becomes recognised within the OECD as the "*smartest*" tax policy setting country and having the best governed and most effective tax administrative regime.