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1 May 2009

AFTS Secretariat  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [AFTSubmissions@treasury.gov.au](mailto:AFTSubmissions@treasury.gov.au)

Dear Sir/Madam

## **PITCHER PARTNERS SUBMISSION**

This submission is made by Pitcher Partners Melbourne. We are part of the Pitcher Partners Association of Firms which comprises five independent firms operating in Melbourne, Adelaide, Sydney, Brisbane and Perth. Collectively we would be regarded as one of the largest accounting associations outside the Big 4.

Our specialisation is servicing and advising smaller public companies, large family businesses, small to medium enterprises (“SMEs”) and high wealth individuals – which we refer to as the “middle market”.

Our submission points have been compiled from our own experience as Tax Practitioners and Advisors and from a recent client Tax Reform survey.

In our view, the Henry Review Panel should have “market sector” differentiation in mind when reviewing submissions. Whilst there is commonality of many issues across enterprises, there are some diverging issues which seem to be largely dependent upon the size of the relevant enterprise.

For instance, the Big 4 accounting firms will be largely focused on the large enterprise issues (\$250M plus turnover). We believe the issues relevant to such enterprises are adequately covered in other submission so our focus is principally, although not exclusively, directed at issues for the SME market ie. \$2M to \$250M turnover.

The key issues coming from our recent client survey are as follows:

- i. Complexity.
- ii. Compliance costs.
- iii. Lack of business and investment incentives.

We do not purport to have answers to all of the issues and acknowledge the difficulty and competing interests in designing a tax system. Hopefully our comments provide the Panel with useful background to the issues facing the SME marketplace.

We would be pleased to meet to discuss these issues or elaborate on any of the points in our submission.

Yours faithfully  
PITCHER PARTNERS ADVISORS PROPRIETARY LIMITED

R CUMMINGS  
Executive Director

# PITCHER PARTNERS SUBMISSION ON TAX REFORM

## **EXECUTIVE SUMMARY**

### i. GST and Superannuation

We acknowledge the recently announced review of the superannuation system. Whilst this is welcomed, we believe there should also be a review of the GST. In our view, it is not possible to have a comprehensive review of Australia's Taxation System unless all elements are subject to review.

### ii. Complexity and compliance costs

The combination of these issues is a key matter which needs to be addressed as a matter of urgency.

### iii. Lack of incentives

The current tax system does not provide appropriate or adequate incentives for business or for investment.

### iv. Negative Gearing

In our view, the deductibility of interest should be maintained. Interest should be deductible regardless of whether the funds are borrowed for use in a business or used to acquire passive assets such as equities, real estate or other property.

### v. State and other taxes

State and local taxes and levies are a constant source of frustration and irritation for business. The review should examine whether or not it is possible to reduce and/or eliminate the number of taxes and to deal with Revenue sharing and collection with the States in a different way.

### vi. Fringe Benefits tax

There is undue compliance cost associated with the fringe benefits tax. Given that it only constitutes approximately 1% of total revenue, it would appear to function as an anti-avoidance measure. Accordingly, consideration needs to be given to whether or not there is a more cost efficient way of dealing with the issues of taxing benefits.

### vii. Capital Gains tax

Feedback from clients is that capital gains is regarded as highly complex. Any simplification would be welcome particularly in relation to the Small Business CGT concessions.

viii. Dividend Imputation

There is strong feedback from clients that this system should be retained.

ix. International Tax

There are many tax inefficiencies inherent in the design of Australia's International Tax System. Key concerns are to ensure that the tax system encourages inbound investment and also encourages outbound investment by eliminating, in particular, the "double" taxation of company profits.

x. Environmental and Infrastructure Sustainability

There is a strong support within the business community for the concept that the tax system should provide incentives for businesses which provide sustainable environmental and infrastructure opportunities to the community.

xi. A simpler tax system for SMEs

Many areas of tax are focused around issues associated with Australia's biggest public companies but the tax legislation applies equally to much smaller enterprises. This places a proportionately higher compliance burden on smaller enterprises. Consideration needs to be given to the adoption of a simpler set of rules for SMEs.

xii. Australian Taxation Office

The ATO has a role not just in collecting revenue and administering the tax system but also educating taxpayers. Due to resourcing or other issues, there are many areas where improvements need to be made.

xiii. Tax Rates

The Review should carefully consider the level of both corporate and personal rates. It should also consider the viability or otherwise of aligning the top personal rate with the corporate rate. At a more radical level, consideration should be given to something like a 20/20/15 model so that the corporate and personal rates are 20% and the GST rate could be say 15%.

## ***GST & SUPERANNUATION***

A review of the Australian tax system would not be complete without a review of GST and Superannuation. We welcome the recently announced review of the superannuation system. However, the absence of a GST review will surely diminish any outcome from the Henry Review. We note that our clients nominated GST as the most complex area of taxation. Clearly this underscores the need for a review.

## ***COMPLEXITY AND COMPLIANCE COSTS***

Often the complexity of tax legislation is simply due to the complexity of the issue. In some cases, the complexity comes from the sheer volume of the legislation.

In far too many cases the complexity is due to the legislative design.

The way in which tax legislation is written adds to complexity, uncertainty and increased compliance costs.

The legislation is often written as a one size fits all and often with a general anti-avoidance purpose. This means that the legislation is nearly always designed as a broad based catch-all provision with carve outs and exceptions.

This leads to interpretive problems. The first matter to be determined is whether or not a particular transaction or event is caught in the first place (and whether or not it should be) from a mischief point of view. Secondly, if the transaction is caught, then does it fall within an exception. The above analysis often requires review of many, many pages of legislation or more and several hours of serious contemplation.

In terms of compliance cost, this takes just as long for an SME as it does for a Top 100 company and sometimes longer because of the interaction of so many other legislative provisions which may not apply to a corporate group.

The legislative drafting style leaves much to be desired. Each piece of legislation is extremely long and cumbersome to read with cross definitions and often very few, if any, signposts to other parts of the legislation or clearly set out operative provisions.

Much of this could be very simply fixed by using plain English and a more user friendly style of setting out and signposting the legislation and expressing the policy intent of legislation more clearly at the start of each Division. In addition, user tools such as flow charts would add to ease of understanding. We have attached a suggested template for legislation in the Appendix.

## ***LACK OF INCENTIVES***

The feedback is very clear that clients consider there are inappropriate or inadequate tax incentives for both business or for investment.

Some respondents have been able to access research and development concessions and more recently the investment allowance. However, many of the detailed responses to our Client Survey indicated that ability to access such concessions was largely fortuitous and their business and investment behaviour had not been significantly influenced by the availability of such measures.

There was a strong view that government should encourage, through tax concessions investment in businesses associated with infrastructure and environment and other areas which will provide sustainable, long term outcomes for the community.

## ***NEGATIVE GEARING***

The issue of abolishing negative gearing appears to resurface on an annual basis. The strong feedback from our clients is that negative gearing should be retained.

The clear attitude of the SME market is that investors and business people should be entitled to a deduction for interest expense regardless of whether the funds are borrowed for use in an active business or are used for the acquisition of passive income producing assets such as equities, real estate and other property.

## ***STATE AND OTHER TAXES***

Businesses in particular are faced with a myriad of taxes at a Federal, State and local level.

This is often regarded as far too many levels of red tape. Most businesses would welcome the scrapping of all State taxes and have a central revenue authority such as the ATO to collect taxes and distribute revenue to the States as appropriate. This would eliminate the compliance burden associated with dealing with multiple Revenue authorities and multiple reporting requirements.

## ***FRINGE BENEFITS TAX***

It is noted that fringe benefits tax collections represent approximately 1% of total revenue collections. Accordingly, as this is not a significant revenue stream for Government, it would seem to serve the role of an anti-avoidance tax to prevent people from converting income into benefits.

The key complaint of businesses is that the compliance and reporting requirements of the fringe benefits tax are overly onerous. Any measures which could be taken to reduce this compliance burden or otherwise deal with the anti-avoidance aspect of converting income into benefits would be welcome.

## ***CAPITAL GAINS TAX***

Our clients nominated this as the most complex area of tax (after the GST).

Given this feedback, any improvements to simplifying the CGT would be welcome.

It may be that a system such as a sliding scale could be adopted. For instance, the capital gains rate could reduce the longer an asset has been held.

We note that the small business CGT provisions are exceedingly complex. Despite many changes to these rules there are discrepancies and inconsistencies between the various types of holding structure and difficulty in determining whether an asset is passive or active.

If a simpler holding period test were adopted, many of these complexities would be eliminated. This may well be too simplistic but should be considered.

## ***DIVIDEND IMPUTATION***

The strongest result of our survey was in excess of 95% of respondents wishing the dividend imputation system to be retained.

We strongly support this view and highlight that a return to the classical system would resurrect all of the issues of double taxation which were associated with that system. Such a move would be severely detrimental to private investors, self managed and other superannuation funds and also the bulk of SME businesses.

## ***INTERNATIONAL TAX***

Whilst we acknowledge and support the many changes made to the Australian International Tax System such as the introduction of the CGT exemption for holdings in active subsidiaries (both on an outbound and inbound basis) there are many other inefficiencies for both inbound and outbound investment which need to be addressed.

For instance, the same CGT exemptions do not apply where a business is conducted through an entity other than a corporate entity. In addition, there is an effective “double tax” for outbound corporate entities. As detailed in so many other submissions this occurs because shareholders in the ultimate Australian corporate entity do not receive a credit for the underlying foreign tax paid by the foreign subsidiary,

The corollary to this is that inbound investors suggest that the 30% corporate rate in Australia is too high. In some regards, this is because their home jurisdictions similarly do not allow them a credit for the underlying tax. The inbound enterprises call for a lower Australian corporate tax rate would mean that their after tax return could be increased.

We acknowledge that these are major policy issues and solutions would come at a cost. The outbound investment issue could be remedied by allowing the ultimate Australian shareholders a credit for the foreign underlying tax. Similarly, if it was considered desirable to encourage inbound international investment, foreign shareholders could receive a refund of tax when a dividend is paid to them. This could occur without reducing the Australian headline corporate rate. Other issues which could be considered for encouraging inbound investment could include tax holidays or similar concessions.

## ***SUPPORT FOR THE AUSTRALIAN ENVIRONMENT & INFRASTRUCTURE***

There is strong support amongst our client base for the tax system to provide incentives for businesses operating in businesses which will provide sustainable solutions to the Australian community.

Businesses operating in areas such as energy, water conservation, health, transport and other similar areas could be eligible for some type of tax concessions. As for international investment, this could take the place of more generous research and development concessions, investment allowances or tax holidays for businesses providing sustainable solutions which are of benefit to the community.

## ***SIMPLER SYSTEM FOR SMES***

As stated above, the legislative design is often one where a “one size fits all”. Legislation designed for transactions and other issues facing major corporates are applied equally to SMEs. In many cases, this adds complexity that is unwarranted for smaller enterprises.

In our view, there is merit for a two tier type tax system. There could be a set of base rules applying to all enterprises and more complex rules such as Taxation of Financial Arrangements and tax consolidation could apply only to larger enterprises. Based on current categorisation, we would adopt the large business \$250M plus turnover as being the cut-off for the more complex rules.

Other issues which could be considered within the SME marketplace would include lower tax rates for enterprises with a lower turnover or profit. Alternatively, there could be a stepped system grading up to a 30% or even 35% tax rate.

We also believe that the flow through corporate entity type option recommended by some organisations could have some merit for SMEs if it could be adopted on an elective basis.

## **ATO ADMINISTRATION**

Burgeoning compliance costs are due not only to the complexity of the legislation but also to requirements for endless form filling and rigid administration of the tax legislation Act by the ATO.

It is beyond the scope of our submission to detail at length the issues we encounter with the role of the ATO as revenue collectors or as administrators of the law. However, there are many instances of overly rigid administration, changing interpretations of the law and reversal of long held views. Similarly, there are often many difficulties in obtaining any answer at all to the application of law without seeking Private Rulings which of itself is often a lengthy and costly process. Tax legislation has become so complex that it is also often well beyond the interpretive abilities of even senior ATO officers. In other words, there is actually no one who knows what a particular piece of legislation means.

All of these are areas which need to be examined and improved so taxpayers can have a consistent and reliable tax administration.

## **TAX RATES**

Careful consideration needs to be given to the balance between the corporate tax rates and the personal tax rates. Popular opinion would seem to be calling for an alignment of the two rates. (At a simplistic level, much of the tax arbitrage between individuals and corporate entities could be eliminated if these rates were aligned.)

Consideration should be given to something like a 20/20/15 model – corporate and personal tax rates would be 20% and GST would be 15%. This would simplify the tax system as capital gains and income would be taxed at the same rate and all taxpayers and taxpaying entities would have the same tax rate.

If the GST rate were increased, this would be revenue neutral for businesses (as a general statement) and the burden of the increased GST would fall on consumers. Clearly, compensation would need to be provided to lower income earners but the increase in GST rate would compensate for the drop in personal rates.

In our view, whilst a 20/20/15 regime may seem a radical proposition and the prospect of increasing the GST rate politically unpalatable, it would be of great interest to the business community if some costings were done on this or a similar model.

**APPENDIX 1*****STANDARD LEGISLATION FORMAT***

<b>Intent of Division</b>
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- |        |   |
|--------|---|
| Part 1 | Operative Provision                       |
| Part 2 | Pre-conditions for Operation of Division. |
| Part 3 | Exceptions.                               |
| Part 4 | Definitions.                              |