

COMMENTARY

NEWS AND ARTICLES
FOR OUR CLIENTS

ADVOCACY

By Ray Cummings, Executive Director – Tax Consulting, Melbourne

You have no doubt heard of Ken Henry's review into the Australian Taxation System. Pitcher Partners undertook a survey of our clients to get the views of businesses on the current system and how it could be improved.

Thanks to all of you who responded to our on-line survey and participated in the workshop. Our submission to the Review is available on the Pitcher Partners website at www.pitcher.com.au/news.pro

The key points raised by clients were:

- Complexity
- Cost
- Lack of business and investment incentives

Below are some of the key findings from our survey.

Corporate Tax Rates

61.8% of respondents favoured a retention of the current rate 37% favoured a lower rate 75.6% said "no" to a reduction in the corporate tax rate if it meant a corresponding increase in the GST rate

Commentary

- It is interesting and perhaps somewhat surprising to note that more respondents were satisfied with the 30% corporate tax rate than a lower tax rate.
- Respondents were not asked whether they were in favour of a sliding corporate rate or some other mechanism of taxing corporate profits. However there does seem to be a reasonable level of anecdotal support for such a measure.
- As GST is 'off limits' in the scope of the Henry Review, there is no point hypothesizing on what a change in the GST would mean for business, but our results indicate any increase in rate would remain extremely unpopular regardless of what the beneficial trade offs maybe.

Personal Tax Rates

80% favoured an alignment of the top personal tax rate to the corporate tax rate of 30%

Commentary

- Respondents are clearly of the view that a personal tax rate of anything in excess of 30% is too high
- By aligning the corporate rate and the personal rate, some of the tax arbitrage behaviour which occurs could be eliminated
- We note that on current personal tax rate scales, an individual would be earning in excess of approximately \$180,000 to have an average tax rate in excess of 30%
- Given current economic conditions, the prospect of significant personal income tax rate cuts would seem too remote.



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Capital Gains

70% are dissatisfied with the current system of taxing capital gains 84% favoured a sliding scale system so that the amount of tax would be reduced the longer the asset has been held Capital gains was nominated in the Top 4 areas of tax complexity

Commentary

- The survey did not set out specific reasons about dissatisfaction with the current system of taxing capital gains
- It was clear from the survey that most of the respondents considered capital gains to be very complex
- Although the reasons were not highlighted in the survey, some of the difficulties could arise due to:
 - The complexity of the small business CGT provisions;
 - The differences in taxation of capital gains and after tax outcomes across different types of entities such as companies and trusts versus individuals, and
 - The distinction between when an asset sale would be regarded as on revenue or capital account.
- The strong support for a sliding scale system indicates a desire for a simpler system and perhaps one which SME business and investment holders consider to be more equitable. Under a sliding scale system, business owners and investors would be rewarded for holding patient capital as the tax rate would reduce the longer the asset had been held

Incentives

77% said there were no appropriate incentives for business 70% said there were no appropriate incentives for investment

Commentary

- The feedback is very clear that clients consider there are inappropriate or inadequate tax incentives for both business or for investment.
- Some respondents had been able to access research and development concessions and more recently the investment allowance. However, many of the detailed responses indicated that ability to access such concessions was largely fortuitous and that 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.



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System Design

65% were not in favour of a flow through type system to tax shareholders rather than companies on underlying gains or income

60% would view favourably a system where taxable income was based on the audited accounting profit

78% were in favour of a two tier tax system involving less complex rules for SMEs

Commentary

- Some early submissions to the Henry Review recommended a system for taxing SME companies as flow through vehicles in the same manner as a discretionary trust. Whilst this has the merits of simplicity and limited liability protection, respondents did not favour such an approach.
- In our view, an entity of this nature, perhaps on an elective basis has considerable merit in the SME market place.
- There was strong support for a system where taxable income would be based on audited accounting profits.
- Respondents were presumably attracted by the simplicity of such a concept rather than having to calculate permanent and timing adjustments to arrive at taxable income. However, respondents were not asked whether
- they would still be in favour of such a system if their accounting profit exceeded what would otherwise be their
- taxable income. Presumably the answer would not be the same.
- There was strong support for a two tier tax system. Such a system could have a set of base rules which applied to all taxpayers and more complex rules such as the existing rules relating to tax consolidation, taxation of financial arrangements and the like, could exclude SMEs.
- A more difficult question was the dividing line as to which taxpayers would be subject to the less complex system. A turnover cut-off was suggested but the survey provided mixed results in terms of where respondents believed the turnover cutoff should be, although \$100M seemed to be the most popular.

Negative Gearing

87% of respondents want negative gearing maintained

Commentary

- There was overwhelming support for retaining negative gearing.
- Given the feedback, any move to eliminate negative gearing would appear to face the same backlash that it did in 1987.
- Businesses and investors are clearly of the view that there should be an entitlement to deduct interest regardless of whether the funds are borrowed for use in an active business enterprise or for passive investment such as acquisition of property, equities or other investments.



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Dividend Imputation

96% of respondents were not in favour of abolishing dividend imputation

Commentary

- The strongest response of the survey was in relation to retaining dividend imputation. This is a clear message that SME businesses and investors perceive the benefits of the system.
- There has been much public debate, particularly in the media about the merits of scrapping dividend imputation. In part, this concept has arisen from some of the major corporates lobbying for a lower corporate tax rate. It has been suggested that this drop in rate would encourage foreign investment into Australia as the after tax return to such investors would increase. On its own, this concept may have some merit. However, the second leg of the argument was to scrap dividend imputation in order to pay for the drop in the corporate tax rate. Conceptually, this might have merit but for private investors and private businesses, scrapping dividend imputation would lead to double tax so would be significantly detrimental to business and investment outcomes.

Complexity

87% of respondents found tax very or extremely complex

81% of small practice accountants also found tax very or extremely complex Clients estimated their compliance costs have increased significantly over the last five years

The top four areas of complexity are as follows:• GST

- ***CGT***
- ***Tax Consolidations***
- ***Trust***

Commentary

- Whilst we were not surprised the SME market considered tax legislation to be complex, we were surprised that so many found tax to be either very or extremely complex.
- Likewise, and again not surprising, a very high percentage had experienced significant increase in tax compliance costs over the last five years.
- In terms of areas of complexity, perhaps the only surprise was that GST was so high on the list. It was ranked first in degree of complexity. This was meant to be a simple transaction tax but feedback from respondents is clear that the opposite is the case.
- The survey did not ask the reasons for the complexity but obvious reasons would include the constant changes in all areas and the difficulties in interpreting and applying tax legislation.



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Other Issues

Commentary

- Our survey did not cover international tax but many respondents raised issues in relation to reviewing international tax. There are many areas in which tax inefficiencies or inequities arise for both inbound and outbound investors.
- Many respondents raised issues with the multitude of different taxes and charges, particularly at a State level.
- Many respondents believed GST and superannuation should be included in the Henry Review.

Ken Henry will deliver his findings and recommendations in December – in the meantime we will continue to lobby and advocate for changes to the tax system that will be fairer and simpler for our client base.



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