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By email: prebudgetsubs@treasury.gov.au

Dear Sir/ Madam

2020-21 PRE-BUDGET SUBMISSIONS

We refer to the media release issued on 27 July 2020 by Assistant Treasurer Michael Sukkar calling for further submissions in relation to the priorities for the 2020-21 Federal Budget. We are pleased to present our submission in relation to taxation and our views on areas the Government should prioritise in the upcoming Budget.

About Moore Australia

Moore Australia is an accountancy and consulting network of independent firms providing services to several industries with a key focus on small to medium enterprises. Our clients range from individuals, small/medium businesses to larger corporate groups with multinational presence.

Overview

Any changes to the Australian tax system need to be well thought out, targeted and delivered within a time frame that makes compliance and tax collection simpler rather than adding layers of complexity and uncertainty for taxpayers and practitioners alike.

Over the last few years, there has often been a substantial time-lag between Government announcements and the finalisation (or even drafting) of tax legislation. For example, the proposed changes to Division 7A of the *Income Tax Assessment Act 1936 (ITAA 1936)* has been delayed for many years and we are yet to see draft legislation in relation to this issue. This legislation is particularly important given the significance of proposed changes which, if enacted, will impact a majority of small to medium businesses operating in Australia.

Recommendations

Our recommendations for the priorities in the upcoming Budget are summarised below and we believe any changes to taxation should framed with the following in mind:

1. Creating jobs and rejuvenating our economy;
2. Simplification of our complex tax system;
3. Fairness and removing inequities; and
4. Supporting innovation and encouraging investment into Australian businesses.

1 Creating jobs and rejuvenating our economy

1.1 Individual Income Tax Rates

We are supportive of the legislated tax rate changes for individuals over the coming years and would also be supportive if they were brought forward subject to maintaining fiscal responsibility. We would not be against introducing a COVID-19 levy for high income earners who earn in excess of $250,000 each year (i.e. income threshold linked to the threshold in Division 293 of the *Income Tax Assessment Act 1997*

(ITAA 1997)) if required to reduce the Budget deficit. We are not supportive of introducing a COVID-19 levy for low/medium income earners.

Further consideration should also be given for *optional* couple assessment, applying to married and de-facto. Essentially, this would ensure families would be able to access marginal tax brackets if one member of the family is not working which may be the case over the coming months and years based on the current projections of unemployment rates. It would also reduce reliance on childcare for families with young children and provide choice to families as to whether one or both parents work.

1.2 Increasing GST and repealing payroll tax

Consideration should be given into whether payroll taxes should be repealed by the States and Territories. Lifting the GST rate and broadening the GST base would compensate for any loss in revenue. As per the *OECD Consumption Tax Trends 2018*, the Australian GST rate is significantly below the OECD average. The average VAT/GST standard rate in the OECD was 19.3% as at 1 January 2019.

The GST rate should be increased to be closer to the OECD average GST/VAT rate. This would enable a reduction in some state taxes which are complex and act as a deterrent to hiring employees. As per the draft report *NSW Review of Federal Financial Relations*, a *draft* recommendation has been made to lift the GST rate and/or expand the GST base over the medium to longer term.

The increase in the GST rate and/or broadening its base should encourage the States and Territory to repeal some of the more inefficient state taxes.

1.3 Superannuation Guarantee Rate

Considering the current economic landscape and pressures on businesses across Australia, we would recommend delaying the increase of the superannuation guarantee rate from 9.5% to 12% which are set to increase between 1 July 2021 and 1 July 2027.

We are currently working with our clients in industries affected by COVID-19 to assist with cash flow planning in what are very difficult times for many. An increase in the superannuation guarantee rate would cause further financial stress for businesses impacted by COVID-19 and further delay their recovery. Additionally, studies have found that the majority of increases in compulsory superannuation guarantee is passed on to employees in the form of reduced salary increases. We would expect this to further delay Australia’s economic recovery.

2 Simplification of our complex tax system

2.1 Company Tax Rate and Franking

Company tax rates in Australia are amongst the highest in any OECD country and we would support the reduction of corporate tax rates to extend to those companies with an aggregated turnover of more than $50 million to encourage more foreign investment into Australia. Rationalising the tax rates to be in line with other OECD countries would also reduce profit shifting.

In relation to base rate entities, it has become apparent that due to the current rules, there are cases of companies moving back and forth between the 30% general corporate tax rate and the reduced tax rate available for a base rate entity (BRE) which has an impact on the franking rate of the entity as that is reliant on the prior income year.

Furthermore, numerous business entities which have paid tax at 30% now have excess franking credits due to the reduction in corporate tax rates for BREs in the 2017-18 income year. These excess franking credits are now “wasted” but represent tax paid by the company which prior to the changes in corporate tax rates would have been passed on to their shareholders. For example, in the early 2000’s, taxpayers were required to adjust their franking account when the company tax rates changed and for some reason, the same was not done when the changes to the tax rates for base rate entities were legislated which led to an inequitable outcome. Due to this disconnect between the franking rate and corporate tax rates, we would recommend allowing BREs to choose their franking rate.

Overall, we would be supportive of (in the following order):

1. Having one lower flat rate of tax for all companies in Australia irrespective of turnover; or

2. If the corporate tax rate is to remain lower for small/medium corporate businesses, we would recommend abolishing the concept of a BRE and having a flat rate of 26% (reducing to 25% in 2021-22) for companies who carry on a business within the meaning contained in Australian Taxation Office (ATO) Taxation Ruling 2019/1; or

3. If the above are not suitable, a BRE should be able to choose their franking rate (either 30% or 26%) which can help in addressing the issue of excess franking credits.

2.2 Small business Capital Gains Tax (CGT) concessions

The small business CGT concessions are complex the Government should consider simplifying the rules to ensure access is targeted, provides taxpayers with greater certainty of eligibility and does not create substantial burden on taxpayers to meet the eligibility requirements. Our recommendations are as follows:

- There should be one turnover threshold for “small” businesses for all provisions contained in the *ITAA 1936* & *ITAA 1997*. It is inappropriate to have the $10 million turnover threshold for businesses under Division 328 of the *ITAA 1997* and a $2 million threshold for Division 152 of the *ITAA 1997*.

- In order to access the small business CGT concessions under the current $2 million turnover test, the relevant taxpayer needs to be carrying on a business. This requirement rules out shareholders/ beneficiaries of Trusts who do not carry on a business unless they pass the maximum net asset value (MNAV) test. Taxpayers who are connected to a small business entity which is a company or trust should have access to the SBCGT concessions based on the turnover of the connected entity.

- Remove the 15-year exemption, active asset reduction and retirement exemption and include a single exemption to simplify the rules and provide certainty to taxpayers.

2.3 Operation of Division 7A of the ITAA 1936

The Division 7A provisions are complex and should be simplified. Conceptually in relation to loans, Division 7A should apply where funds are withdrawn by an individual from a lower tax paying structure (either directly from a company or from a trust if there is a loan owed to a company by the trust).

Division 7A should not apply in instances where funds are distributed by a trust to a company which is used as working capital within the trust. The requirement to automatically treat unpaid present entitlements as financial accommodation (i.e. ‘loans’) led to various issues for taxpayers which seemed inequitable in situations where funds never left a lower tax paying structure(s). We are supportive of an immediate rewrite of these provisions.

We express concern with some of the changes suggested by the Board of Taxation (BOT) in their report *Post Implementation Review of Division 7a of Part III of the Income Tax Assessment Act 1936* which should be avoided such as removing the concept of distributable surplus, the requirement to convert 25-year secured loans to 10-year loans and bringing pre-1997 loans within the scope of Division 7A .

We are supportive of simplifying these provisions and removing the strict documentation requirements.

2.4 Fringe Benefits Tax

The FBT system is complex and does not contribute enough revenue to warrant the continued compliance obligations on employers. We would recommend repealing the *Fringe Benefits Tax Assessment Act 1986* and suggest taxing the market value of benefits provided to employees under the PAYG system.

2.5 Tax Residency

Tax collection is reliant on your tax base and in determining a taxpayer's liability, the residency of the taxpayer is a fundamental issue which needs to be addressed at the outset. One of the critical features of our tax system is to tax our residents on worldwide income. Our residency provisions are principle based and generally require a detailed analysis of current case law which often leads to confusion and incorrect application of our residency tests.

Individuals

The BOT had conducted a self-initiated review of individual tax residency and have released their final report and we recommend adopting the changes suggested by the BOT. In particular, we support the following measures that provide greater clarity and certainty for taxpayers:

- *Individuals coming to Australia*: Implementing the 183-day residency test as the primary test to simplify the current residency provisions when determining whether a person is resident or not (Recommendation 3 of BOT report *Reforming Individual Tax Residency Rules – A Model for Modernisation)*;

- *Individuals leaving Australia*: The current provisions make it possible for individuals to "draw a line in the sand" and treat themselves as non-residents from a particular date and we are supportive of a more gradual shift from residency to non-residency which may reduce aggressive tax planning. Using the days-based approach in relation to long term Australian residents ceasing to be tax residents would be more appropriate making it more difficult for taxpayers to "exit" the Australian tax system. Double tax treaty relief would still be applicable in case they are remain residents of Australia and are also considered tax residents of another treaty partner country which would negate double taxation during this gradual shift (Recommendation 6 of BOT report *Reforming Individual Tax Residency Rules – A Model for Modernisation*);

- *Taxation of dual residents*: dual residents who are tax treaty residents of another country Australia has a double tax agreement (DTA) with receive the benefits of ordinary tax residents (e.g. CGT discount, tax-free threshold etc.). We would recommend taxing these individuals as non-residents (Recommendation 5 of BOT report *Reforming Individual Tax Residency Rules – A Model for Modernisation*).

Companies

The BOT are also in the process of finalising their consultation on the residency provisions in relation to companies. The current definition of resident companies is no longer appropriate in the current global environment, particularly with virtual meetings and decision making reducing the need for travel. We recommend treating the place of incorporation as the sole test for residency of companies. This is because:

- Australia has dynamic controlled foreign company (CFC) provisions in place to deal with entities who are not resident of Australia but are controlled by Australian shareholders. Expanding the

CFC rules to incorporate a wider range of ownership structures may be more appropriate; and

- The concept of permanent establishments (PE) in our tax legislation captures most foreign entities who have a presence in Australia, but the concept of PE should be expanded (as explained below in “3.1 Taxation of Digital Businesses").

3 Fairness and removing inequities

3.1 Taxation of digital businesses

Over the last few years, there has been some traction gained on the taxation of multinationals and we understand the OECD are currently reviewing taxation requirements for digital businesses. In Australia, we now require online sellers to pay GST on sales it makes directly to Australian consumers. This was done to protect Australian businesses where foreign sellers could offer discounted prices because they had no GST liability on the selling price of the product.

Whilst the OECD guidelines seem to be more focused on the ‘bigger players’, within the small to medium space these issues can be tackled by taxing businesses that have a clear *virtual* presence in Australia by selling products through websites.

With many businesses being run through lower corporate tax paying jurisdictions, an option we should be looking at is to legislate changes to the definition of permanent establishment in the *ITAA 1936* which require some sort of *physical* presence. The requirements to have servers and systems in place to create a physical presence seems an outdated concept in the current environment and a substantial *virtual* presence linked to turnover from consumption of products/services in Australia, may be introduced to treat these businesses as having a PE in Australia (possibly linked to the GST registration threshold).

As an alternative to this, our withholding tax requirements to capture these arrangements could be expanded.

3.2 Main residence exemption – non-residents

The legislation introduced to deny non-residents the main residence exemption is inequitable. The denial of the exemption is based on a “point in time” test and no apportionment is allowed where the taxpayer was a tax resident during a period of ownership of the property. This is a strange and inequitable outcome considering when similar laws were imposed on non-residents which denied them the 50% CGT discount, they could claim a reduced CGT discount percentage based on periods of residency.

3.3 Main residence exemption

The main residence exemption (along with the discount associated with the exemption) is estimated to cost $42.5 billion during the 2020 income year alone. As highlighted in the *2019 Tax Benchmarks and Variations Statement 2019*, the following are the estimated costs to the Australian economy:

E6 Main residence exemption

Housing and community amenities ($m)

2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
27,000	29,500	30,000	23,000	19,500	19,000	20,000	20,500

Tax expenditure type:	Exemption	*2018 code:*	E6
Estimate Reliability:	Low		
Commencement date:	1985	*Expiry date:*	
Legislative reference:	Subdivision 118-B of the *Income Tax Assessment Act 1997*		

E7 Main residence exemption — discount component

Housing and community amenities ($m)

2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
32,500	35,500	35,500	27,500	23,000	22,500	23,500	24,500

Tax expenditure type:	Reduction in taxable value	*2018 code:*	E7
Estimate Reliability:	Low		
Commencement date:	1999	*Expiry date:*	
Legislative reference:	Division 115 of the *Income Tax Assessment Act 1997*		

The main residence exemption works by way of election and taxpayers can choose their main residence if they own multiple properties, provided they used the residence as their main residence for a period of time and they can elect to treat the property as their main residence during period of absences even if the property was producing income. The threshold for meeting the requirements for the main residence exemption are low. In our opinion, the exemption should be limited to actual use of a property as a main residence.

Our recommendations include:

- *Access to exemption*: Legislate a minimum period of stay (e.g. two years) to be able to elect to treat a property as your main residence. In exceptional circumstances cases, this can be reduced by discretion of the Commissioner of Taxation (for example, sale of property due to marriage breakdown).

- *Individuals owning multiple properties* - For taxpayers who own more than one property, remove the choice to treat a property as your main residence if you do not reside in it and remove the absence concession if the property is available for rent.

4 Supporting innovation and encouraging investment into Australian businesses

4.1 Research and Development (R&D) Offset

We support amending the R&D offset to better support Australia's innovation agenda. The current self-assessment regime is creating angst amongst Australian businesses, as the program is complex and has a highly subjective application process. Taxpayers are being drawn into unreasonably long post compliance measures, sometimes resulting in a requirement to repay funds for ineligible claims retrospectively. This uncertainty is deterring businesses from engaging in the program and/or encouraging businesses to move their R&D activities offshore.

We support a simplified regime aimed at the small and medium business sector and supports collaboration with universities. A program that is designed to provide certainty around financial support, encourages business to retain R&D activities in Australia and that appropriately addresses Australian innovation agenda will have a significant positive impact to the economy.

We note that the Senate Committee report is deferred until after the Federal Budget. We would encourage the government to reconsider any proposed reduction in the net benefit allowable under the R&D program to ensure the Australia is an attractive location to conduct R&D activities, leading to greater innovation and job creation.

We thank you for giving us the opportunity to make this submission and if you have any queries in relation to this, please contact Varun Kumar or me on 08 9225 5355.

Yours sincerely,

DAVIDE COSTANZO
Chairman – National Tax Committee
Moore Australia