THE TAX INSTITUTE

23 October 2019

The Hon Josh Frydenberg MP
Treasurer
C/- Budget Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: josh.frydenberg.mp@aph.gov.au, prebudgetsubs@treasury.gov.au

Dear Treasurer,

2020-21 Federal Budget Submission

The Tax Institute welcomes the opportunity to make a submission to the Treasurer in relation to the 2019-20 Federal Budget.

We refer to the media release issued by the Assistant Treasurer, the Hon Michael Sukkar MP on 30 September 2019 inviting submissions for the 2020 – 21 Federal Budget[1], where the Government has expressed its plan for a stronger economy and to secure a better future for all Australians.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to Appendix A for more about The Tax Institute.

The Tax Institute considers that a structurally sound Australian tax system is required to support a strong economy and ensure sufficient revenue is raised to support the provision of essential services relied upon by Australians, thus securing a better future for all Australians.

To achieve a structurally sound Australian tax system, one must cast an honest and critical eye over the current system and decide whether all the features of the current system should remain or should be removed in favour of new or modern features that better support Australia's economic needs. Such a pursuit requires a strong political will.

The Tax Institute submits that certain trade-offs will have to be made between current features of the Australian tax system in order to ensure a structurally sound tax system is set up for the future. In addition, the opportunity should be taken to resolve known and recognisable distortions in the tax system that adversely influence taxpayer behaviour. Please refer to our submission in Appendix B which contains a detailed analysis of our submission previously made to this Government.

[1] http://ministers.treasury.gov.au/ministers/michael-sukkar-2019/media-releases/2020-21-pre-budget-submissions

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The Tax Institute does not in general have a view on how much revenue the Government should raise. This depends in part on spending and budgetary matters which are not the Institute's areas of expertise. The Institute's objective is to make recommendations for improvement of the Australian tax system overall.

Our submission, detailed in Appendix B, is based on the assumption that, for the foreseeable future, the current Government (and future governments) will seek to raise very substantial amounts of revenue as a percentage of GDP. In this regard, comments in our submission to the effect that any particular form of tax should be relied on or continue to be levied should be read in this light, being as if the words 'to the extent necessary to raise the desired amounts of revenue' were included in our comments.

If you would like to discuss any of the above, please contact Tax Counsel Stephanie Caredes on 02 8223 0059.

Yours faithfully,

Tim Neilson
President

Peter Godber
Vice President

APPENDIX A

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of almost 12,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.

APPENDIX B

Tax Institute Proposal - Trade-offs

1. Overview

The Tax Institute proposes that the Government needs to look at where trade-offs can be made in the Australian tax base to ensure Australia has the requisite tax system to support the Australian economy into the future. A trade-off will involve changes being made to the Australian tax base that may increase or decrease revenue. For example, the repeal of a particular tax will reduce revenue and narrow the tax base. Removal of certain exemptions and concessions will increase revenue and broaden the tax base.

A thorough consideration of where trade-offs can be made in the Australian tax system needs to be undertaken. Our submission is intended to point the Government in the direction of where The Tax Institute believes trade-offs should be considered.

2. Reduce the number of tax bases

In the *Australia's Future Tax System – Report to the Treasurer* (**Henry Review**) released in December 2009, Recommendation 1 was:

> ***Recommendation 1:*** *Revenue raising should be concentrated on four robust and efficient broad-based taxes:*
>
> - *personal income, assessed on a more comprehensive basis;*
> - *business income, designed to support economic growth;*
> - *rents on natural resources and land; and*
> - *private consumption.*
>
> *Additional specific taxes should exist only where they improve social outcomes or market efficiency through better price signals. Such taxes would only be used where they are a better means to achieve the desired outcome than other policy instruments. The rate of tax would be set in accordance with the marginal spill-over cost of the activity.*
>
> *User charging should play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services.*
>
> *With both specific taxes and user charges, revenue would be a by-product of the tax or charge, not the reason for it.*
>
> *Other existing taxes should have no place in the future tax system and over time should be abolished.*

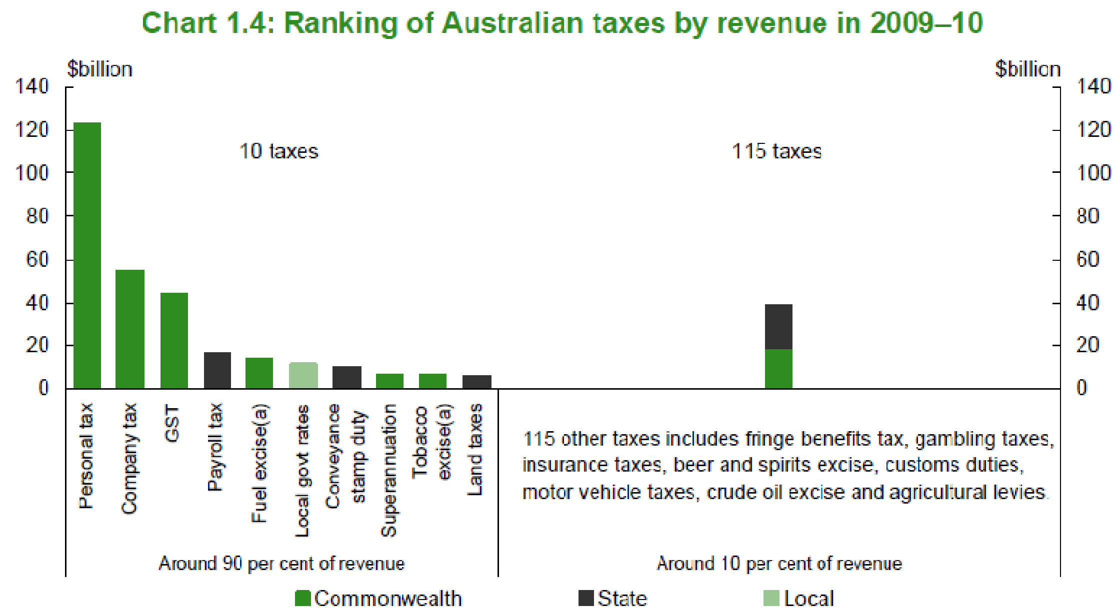
The Tax Institute considers that Recommendation 1 should be the starting point for redesigning the Australian tax system to support the Government's desired goal of keeping the economy strong.

In support of this, we refer to the research prepared by Treasury in the 2008 document *Architecture of Australia's Tax and Transfer system* in which it was stated that:

> *Australians pay at least 125 different taxes each year. Of these, 99 are levied by the Australian government (including 67 agricultural levies), 25 by the States and 1 (council rates) by local*

government. The exact number of taxes is difficult to determine and may be higher than these estimates[2].

A summary table of these taxes was included in the Henry Review[3] and is extracted below:



(a) Fuel excise and tobacco excise includes excise equivalent customs duties for these products.
Source: Treasury estimates.

The diagram clearly depicts the 10 taxes that contribute to 90% of the revenue take and the 115 taxes which only contribute to 10% of the revenue take.

To move towards the four clearly defined tax bases suggested in Recommendation 1 of the Henry Review would require an enormous number of very small taxes to be repealed. This would require serious consideration being given to which of the 115 taxes should be repealed. This would require a review of the policy behind the taxes, whether the effect of the tax (eg to institute behavioural change or to address a mischief) is still a relevant consideration today. This would also require co-operation from the States and Territories as many of the numerous smaller taxes are State and Territory – based.

The ‘trade-off’ that would occur would be between the loss of revenue and the relevant impact of the taxes. A contentious matter would be, for example, repealing Fringe Benefits Tax – where there would be a trade-off between the loss of the small amount of revenue and the large compliance saving to taxpayers and the administrator, the Australian Taxation Office (**ATO**) by removing this tax.

The Tax Institute considers that proper consideration needs to be given to the repeal of the 115 taxes that do not contribute much to the revenue. While collectively these taxes contribute 10% to revenue, they contribute very little when considered individually. The revenue collected is prima facie unlikely to justify the compliance burden associated with maintaining these taxes. Repeal of these taxes would have the additional benefit of simplifying the Australian tax system.

[2] Part 2.3 at p10
[3] Part 1, p12 Chart 1.4

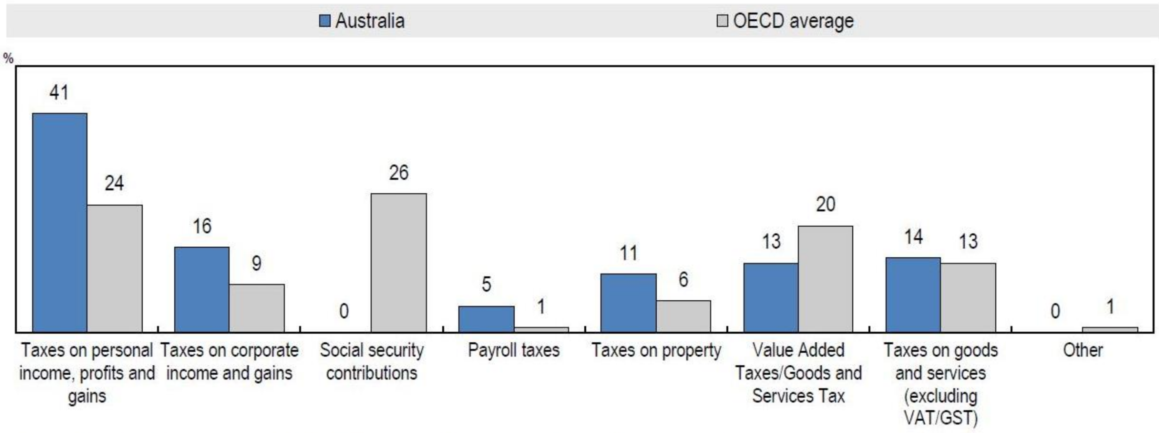
3. Move towards more efficient tax bases

Australia's current tax mix relies heavily on income tax bases (both personal and corporate) for the majority of the revenue collection. This mix is out-of-step with Australia's counterparts in the Organisation for Economic Co-operation and Development (**OECD**) whose tax systems rely more heavily on broad-based consumption taxes. This is evident in the diagram[4] below where the percentage of revenue from certain sources in Australia is compared to the OECD average[5].

Tax structures

Tax structure compared to the OECD average

The structure of tax receipts in Australia compared with the OECD average is shown in the figure below.



Relative to the OECD average, the tax structure in Australia is characterised by:

» Substantially higher revenues from taxes on personal income, profits & gains, and higher revenues from taxes on corporate income & gains; payroll taxes; property taxes; and goods & services taxes (excluding VAT/GST).

» A lower proportion of revenues from the Goods and services tax.

» No revenues from social security contributions.

In the table[6] below, Australia's ranking in the OECD according to the highest share of revenue coming from certain sources, ranks Australia 2nd highest (in 2016) for taxes on income, profits and capital gains. Australia is ranked 34th out of 36 countries in terms of the share of revenue from GST/VAT.

[4] https://www.oecd.org/ctp/tax-policy/revenue-statistics-australia.pdf

[5] The diagram indicates there is no equivalent in Australia to 'Social Security Contributions'. This includes 'all compulsory payments that confer an entitlement to receive a (contingent) future social benefit' (Refer to OECD (2018), *Revenue Statistics 2018,* OECD Publishing, Paris, Annex A at paragraph 39). We suggest that Australia's Superannuation Guarantee scheme fulfils this role to some extent.

[6] https://www.oecd.org/ctp/tax-policy/revenue-statistics-australia.pdf

Tax structure	Tax Revenues in national currency			Tax structure in Australia			Position in OECD[2]		
	Australian Dollar, millions			%					
	2016	**2015**	**Δ**	**2016**	**2015**	**Δ**	**2016**	**2015**	**Δ**
Taxes on income, profits and capital gains[1]	278 764	262 357	+ 16 407	57	57	-	2nd	2nd	-
of which									
Personal income, profits and gains	198 534	191 747	+ 6 787	41	41	-	2nd	2nd	-
Corporate income and gains	80 230	70 610	+ 9 620	16	15	+ 1	3rd	3rd	-
Social security contributions	-	-	-	-	-	-	36th	36th	-
Payroll taxes	23 799	23 354	+ 445	5	5	-	3rd	3rd	-
Taxes on property	52 585	49 641	+ 2 944	11	11	-	6th	5th	- 1
Taxes on goods and services	131 930	127 998	+ 3 932	27	28	- 1	28th	27th	- 1
of which VAT	62 727	60 312	+ 2 415	13	13	-	34th	34th	-
Other	-	-	-	-	-	-	34th	34th	-
TOTAL	487 078	463 350	+ 23 728	100	100	-	-	-	-

Tax revenue includes net receipts for all levels of government; figures in the table may not sum to the total indicated due to rounding.

1. Includes income taxes not allocable to either personal or corporate income.

2. The country with the highest share being 1st and the country with the lowest share being 36th.

Source: OECD Revenue Statistics 2018 http://oe.cd/revenue-statistics

This clearly demonstrates Australia is out-of-step with its OECD counterparts. The effects of this discrepancy should be analysed. The discrepancy could be mitigated by the Government adopting a policy of shifting away from being dependent on income tax for the bulk of revenue collections towards more simple and efficient consumption taxes.

4. Simplify the tax bases to be retained

a) Personal income tax base

The personal income tax base should be simplified as much as possible. Further, the personal marginal tax rates should be reassessed in light of the table above which shows that Australia is ranked 2nd highest for rates on personal income, profits and gains in the OECD.

The Henry Review made a number of recommendations to improve the personal income tax base, some of which have been extracted below for reference:

> ***Recommendation 2:*** *Progressivity in the tax and transfer system should be delivered through the personal income tax rates scale and transfer payments. A high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity.*
>
> ***Recommendation 3:*** *The primary unit in the personal tax system should continue to be the individual, and subsidies for dependants through the tax system should be restricted (see Recommendation 6a). However, there could be a case for optional couple assessment for people of late retirement age.*
>
> ***Recommendation 5:*** *The Medicare levy and structural tax offsets – the low income, senior Australians, pensioner and beneficiary tax offsets – should be removed as separate components of the system and incorporated into the personal income tax rates scale. If a health levy is to be retained, it could be applied as a proportion of the net tax payable by an individual.*
>
> ***Recommendation 11:*** *A standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation.*

Recommendation 12: *There should be a tighter nexus between the deductibility of the expense and its role in producing income.*

Consideration should be given to these recommendations. In the Institute's view:

- There should be a transparent personal marginal tax rate system so that individual taxpayers can clearly identify which marginal tax bracket they fall into and therefore what tax rate they face. Recommendation 5 in the Henry Review suggests that the Medicare levy and a number of tax offsets should be built into the marginal tax rate system (ie be built into the headline marginal tax rates). Such additional levies and offsets complicate the personal tax rate system and distort the real impost of tax to taxpayers by dealing with social security matters through the tax and transfer system (for example via tax offsets). The Tax Institute sees merit in a review being conducted of all relevant levies and offsets with a view to adjusting marginal tax rates to accommodate the removal of levies or offsets as appropriate.

- In the short-term, a standard deduction for work-related expenses should be introduced together with the option to claim actual expenses properly substantiated for employees with expenses above the standard deduction threshold. This would make it much simpler for individuals/employees to comply with their personal tax obligations.

  Recommendation 11 suggests that the standard deduction should cover both work-related expenses and the cost of managing tax affairs. While The Tax Institute would support investigating whether the standard deduction could apply in lieu of the variety of work-related expenses claims, The Tax Institute does not generally endorse caps on specific deductions, such as the deduction for the cost of managing tax affairs. Such caps are selective and distortionary. There would need to be good policy reasons for imposing a cap selectively on a particular deduction.

  A medium-term goal should be to adopt Recommendation 12 of the Henry Review. We note the House of Representatives Standing Committee on Economics 2017 *Inquiry into Tax Deductibility* considered Recommendation 12 of the Henry Review. However, the Committee recommended[7] that 'the Government maintain the current personal income tax framework that allows Australians to claim deductions for valid expenses, including those related to their work. The committee sees this as an entirely appropriate part of our taxation system' (Recommendation 1).

b) Corporate income tax rate and base

The Tax Institute is of the view that a single corporate tax rate should apply in Australia. Currently, Australia has a dual corporate tax rate system - a headline rate of 30% that applies to all companies other than to 'base rate entities' with a lower aggregated turnover to which a lower rate applies. The dual system (including future changes) is set out as follows:

Income Year	**Aggregated turnover threshold for 'base rate entities'**	**Tax rate for 'base rate entities' under the threshold**	**Tax rate for all other companies**
2019-20	$50 million	27.5%	30%
2020-21	$50 million	26%	30%

[7] Refer to the Report for the inquiry dated June 2017: https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Taxdeductibility/Report

2021-22	$50 million	25%	30%

Extracted below are the headline corporate income tax rates for all 36 OECD countries from current OECD statistics[8]. Australia has the second highest corporate income tax rate (tied with Mexico and Portugal) out of all 36 OECD countries.

Table: Corporate Income Tax Rates of OECD Countries	
Country	**Corporate income Tax Rate (including surtax)**
France	32.02%
Mexico	30%
Portugal	30%
Australia	30%
Belgium	29%
Greece	28%
New Zealand	28%
Korea	25%
Austria	25%
Spain	25%
Netherlands	25%
Chile	25%
Italy	24%
Japan	23.2%
Israel	23%
Norway	22%
Turkey	22%
Denmark	22%
Sweden	21.40%
United States	21%
Slovak Republic	21%
Estonia	20%
Iceland	20%
Latvia	20%
Finland	20%
Czech Republic	19%
Poland	19%
United Kingdom	19%
Slovenia	19%
Luxembourg	18.19%
Germany	15.83%
Canada	15%
Lithuania	15%

[8] https://stats.oecd.org/index.aspx?DataSetCode=Table_II1

Ireland	12.5%
Hungary	9%
Switzerland	8.5%

The dual tax rate system adds unnecessary complexity to the corporate tax rate system. As can be seen above, Australia's corporate tax rate is the second highest in the OECD. We consider that a lower rate no higher than 25% should apply to all companies irrespective of their aggregated turnover. Even a rate of 25% would still have Australia in the top one third of OECD countries' highest corporate income tax rates.

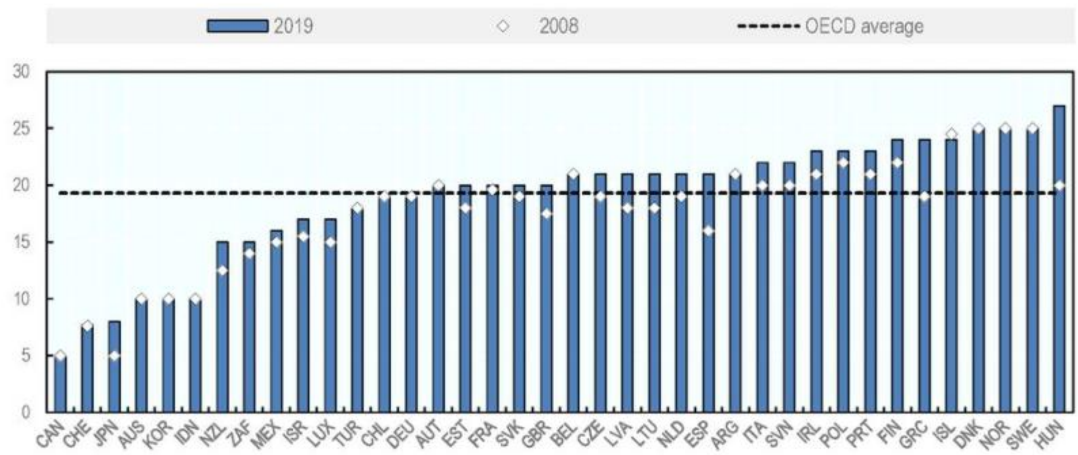
Further, when we look to other countries in the Asia-Pacific region, even a headline corporate tax rate of 25% would be substantially higher than the headline corporate tax rate in countries such as Singapore (which has a headline corporate tax rate of 17%)[9]. A reduction to 25% will still not place Australia in a very competitive position as compared to countries in the Asia-Pacific region. Given the contentious nature of reducing the rate, achieving a 25% rate for all companies is a step in the right direction.

c) GST base

A comprehensive review of the current exemptions and special rules in the GST law which impact the size of the GST base should be reviewed. There is a trade-off between making concessions and exemptions available for certain classes of taxpayers and the increased revenue that could be obtained from removing them.

Australia has the fourth lowest GST/VAT rate in the OECD (see the chart[10] below):

Figure 3.21. Standard VAT rates by country in 2008 and 2019



Note: For Canada, the graph shows the federal GST rate.
Source: OECD Tax Database and OECD Annual Tax Policy Reform Questionnaire.

Only 13% of revenue in Australia comes from GST, whereas the OECD average is 20% (refer to the diagram above entitled 'Tax structure compared to the OECD average').

[9] Often, these countries will also have a narrower corporate tax base – for example Singapore does not tax capital gains or foreign source income.

[10] Extracted from the OECD publication *OECD (2019) Tax Policy Reforms 2019: OECD and Selected Partner Economies*, OECD Publishing, Paris p79 (https://www.oecd.org/tax/tax-policy-reforms-26173433.htm)

Where the GST base can be broadened, this may allow for the reduction in other tax bases, such as corporate tax, or a shift away from less efficient taxes such as the 115 other taxes that individually contribute very little to revenue.

Holistic Tax Reform

Our submission above highlights certain recommendations that were made in the Henry Review which in our view is indicative of the value of recommendations made in the Henry Review. Rather than embarking on a new review for holistic reform of the Australian tax system, The Tax Institute strongly suggests the Government consider the numerous recommendations previously made by the Henry Review. Substantial time and effort was given to this review by stakeholders. The Government could well derive significant benefit from revisiting the Henry Review recommendations in setting the tax and budgetary course for 2020-21 and beyond.