TAX REFORM SUMMIT
Special wrap | 4 pages of news and analysis

Now for action
Taxes are too high, but cutting them is hard
Jennifer Hewett p2

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▶ Unions, welfare groups, economists push to narrow personal income concessions, but don't rule out GST hikes

Company tax cut – at a price

Ben Potter

The Australian Council of Trade Unions, the Australian Council of Social Service and Labor have signalled a willingness to talk about tough tax reform options such as raising the GST and lowering the corporate tax rate in exchange for cuts to tax breaks used by the rich.

The careful concession by the nation's leading civil society groups and the opposition at the AFR Tax Reform Summit on Tuesday, marked a promising advance in the stalled tax reform debate.

It came a day after new Prime Minister Malcolm Turnbull declared all tax reform options were back on the table as he committed his government to changes to spur growth and innovation in the wake of the mining boom's collapse.

But the civil society groups made it clear the price for their participation in the tax reform debate would be an agreement from business to a winding back of superannuation, capital gains, housing and other income tax breaks enjoyed by the rich.

"Let's start by looking for solutions that have stronger equity and efficiency at the moment," said Peter Davidson, senior policy adviser at the Australian Council of Social Services.

"Then we can turn our attention to issues such as the GST if we can't get far enough down that track."

On the first day of the summit, hosted by *The Australian Financial Review* and KPMG, top economist Saul Eslake challenged business to offer cuts to a range of tax breaks such as superannuation, trusts, and capital gains.

Mr Eslake, a former chief economist at Bank of America Merrill Lynch and ANZ Banking Group, said it would be "hypocritical" for business to urge the government to broaden the base of the GST without accepting the need to broaden the base of income tax to make space for cuts.

ACTU president Ged Kearney said she was willing to be part of a debate about whether the 30 per cent corporate tax rate was too high.

But she told the Tax Summit she did not believe the tax reform discussion should immediately leap to raising the GST to fund company tax cuts.

"Having said that perhaps it is too high, I don't know – I'll be in the argument there," she said.

"But I do agree it has to be neutral. We cannot decrease the tax base. Under any changes it has to be neutral, and I don't think we need to leap immediately to the GST to do that."

Earlier, shadow treasurer Chris Bowen said Labor accepted former Treasury secretary Martin Parkinson's argument that the burden of company tax fell most heavily on workers and that Labor would look to cut the rate to 25 per cent over time.

But, as reported in Tuesday's *Financial Review*, Mr Bowen said Labor did not accept that raising the GST was the best way to pay for cuts to company tax or income tax.

Ms Kearney disagreed sharply with Mr Parkinson on where the company tax burden fell at last month's National Reform Summit sponsored by *The Financial Review* and rival newspaper *The Australian*.

But on Tuesday the ACTU president said she was willing to accept that it could be true. "I think there's a danger in saying the only thing that makes a company competitive is a corporate tax rate," Ms Kearney said.

She said other issues such as the exchange rate, the imputation system, played into decisions such as blood products group CSL's decision to put a new manufacturing plant in Switzerland rather than in Australia.

Mr Bowen said Mr Parkinson's statement was "a statement of fact which I agree with."

"I would like to see the corporate tax rate come down over time. I have previously said the nation should be aiming for a 25 per cent corporate tax rate," Mr Bowen said, adding that it would not be easy to do. Rio Tinto Australia managing director Phil Edmands told the summit that CSL had been motivated by tax rates when it made the decision earlier this year to locate the new

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AFR | Tax Reform Summit

Perhaps it is too high, I don't know - I'll be in the argument there.

Ged Kearney, ACTU president, referring to the 30 per cent company tax rate.

It's just not feasible to maintain a 30 per cent rate. It doesn't matter what your philosophical position is. It's just not practical.

Phil Edmands, Rio Tinto managing director

I am stating as a matter of principal that you'd like to see the corporate tax rate come down over time.

Chris Bowen, shadow treasurer

We have been Australia's largest taxpayer over the past decade. We have paid $65 billion in taxes and royalties.

Jane Michie, BHP Billiton head of group tax

PHOTO: SAHLAN HAYES, LOUISE KENNERLEY

Expert commentary

The Prime Minister's options are fairly limited: they are tax, industrial relations and competition policy.

Alan Mitchell p42

The Tax Reform Summit ought to provide strong ammunition for new Treasurer Scott Morrison.

Chanticleer p44

Labor eyes corporate tax of 25pc

Equity

Ben Potter

Shadow Treasurer Chris Bowen says Labor accepts that company tax falls hardest on workers rather than wealthy shareholders, and aims for a 25 per cent company tax rate to spur economic growth.

Asked if he accepted former Treasury secretary Martin Parkinson's statement that company tax falls hardest on workers, Mr Bowen told the AFR Tax Summit: "It's a statement of fact, which I agree with. I would like to see the corporate tax rate come down over time. I have previously said the nation should be aiming for a 25 per cent corporate tax rate."

Mr Bowen added that it would not be easy to do.

The Australian Financial Review's Tax Reform Summit is sponsored by KPMG Australia.

Australia's headline company tax rate of 30 per cent is higher than most advanced economies' company tax rates. Mr Bowen pointed out that the dividend imputation system, which credits Australian company tax paid for Australian-resident shareholders, reduces the effective company tax rate for them.

Business groups point out that this does not apply to foreign shareholders or foreign taxes paid by Australian companies, which makes Australian investors and companies more domestically focused and insular.

Mr Bowen said he wasn't advocating getting rid of the hugely popular dividend imputation system.

The Australian Taxation Office estimates imputation reduces the effective company tax take by about a fifth.

Asked what a Labor government would do to spur innovation and economic growth, Mr Bowen said Labor would not entertain "Laffer curve" calculations that tried to bank revenue increases from tax cuts up front.

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Company tax cut – at a price

plant in Switzerland.

He said it wasn't feasible to maintain a company tax rate higher than rival nations and regions, regardless of your philosophy.

"I guess what the business community is saying is if the UK is moving towards 18 per cent, the OECD is 25 per cent, Asia is moving to 22 per cent, it's just not feasible to maintain a 30 per cent rate," Mr Edmands said.

"It doesn't matter what your philosophical position is. It's just not practical."

Mr Edmands said that although Australia had historically had a big advantage in political stability over other resource-rich nations, some rival nations were getting their political systems in order and as these barriers to investment reduced, "relative tax rates come into play".

Former top Treasury tax official Greg Smith suggested that the global fall in corporate tax rates meant the 30 per cent company tax rate implemented in 2001 needed to fall to 25 per cent now to have the same level of international competitiveness.

But he argued against financing any cut in the company tax rate by increasing the rate of GST, saying that would not be politically sustainable. Instead, he agreed with Mr Eslake about personal income tax concessions.

"The personal income tax rate in Australia has quite a few holes in it," said Mr Smith, who now chairs the Commonwealth Grants Commission.

Premiers push for financial services GST

Exclusive

Joanna Mather and Phillip Coorey

A plan to expand the GST to financial services has earned the support of two of the nation's most popular political leaders, but will be opposed by the banks.

NSW Premier Mike Baird has joined South Australian Premier Jay Weatherill in supporting the taxation of household consumption of financial services if extra money is raised for health.

The push will not be well received by banks, which have previously warned against extending the 10 per cent GST to financial services because the costs will be passed on to consumers.

Mr Weatherill will outline a plan to tax bank profits when he speaks at *The Australian Financial Review* Tax Reform Summit in Sydney on Wednesday.

The change would mean the margin of profit earned by financial institutions on services such as home loans would be taxed at 10 per cent.

"Consistent with the need to keep all options on the table – and for politicians to explain complex issues and make the case for change – the possibility of closing the finance-sector tax gap should not be ruled out," Mr Weatherill will tell the summit.

Mr Baird said he was open to the idea of a GST on financial services – which are GST-free, along with fresh food, health and education.

"As is widely known, I believe the basis of any such [reform] package should be an increase in the rate of the GST," he said ahead of the summit, hosted by *The Australian Financial Review* and KPMG .

"However, inclusion of financial services within the GST, lower income and corporate tax rates, and superannuation reform can all potentially be made consistent with the fundamental principles I have outlined."

Treasury estimates undertaxation of financial services at $4.7 billion in 2015-16, although these figures are widely acknowledged as being rubbery.

South Australia's share of the extra revenue would be $332 million, according to a report commissioned by the state Labor government and written by former KPMG tax partner and now University of Melbourne senior fellow Michael Evans.

The report recommends a "supplementary" tax on margin-based financial services; the difference between what it costs a bank to lend money and what the bank charges its customers, for example.

"In the case of deposit taking and lending, it is the difference between the interest paid and the interest earned over a period," Mr Evans said. "It would essentially be taxing the profits and wages of the banks."

Mr Evans said several countries already had mechanisms in place to tax the "value added" by financial institutions. France and Denmark levied a higher rate payroll tax of businesses that were undertaxed via that country's domestic value added tax or VAT.

"Most of the revenue from this additional payroll tax comes from financial institutions," he said.

"Israel levies a profits-based tax on financial institutions that are exempt under Israel's value added tax."

KPMG tax partner Nick Kallinikos said it was globally recognised that financial services were difficult to tax under a GST regime.

In Europe, some countries have signed up for a financial transaction tax, he said, but the scheme had been delayed.

"These methods are not ideal [and] introduce their own complexities and distortions," he said.

"The impact of [financial transaction taxes] and similar proposed taxes on the competitiveness of our financial services sector needs to be carefully considered, particularly as compared with that of our Asian neighbours."

University of NSW professor Michael Walpole said households would inevitably pay more for financial services if such a change were to occur.

"Although the [report suggests] competitive forces should limit the impact of the taxation being passed on in prices, and it rightly urges surveillance of any price changes by the ACCC, it is important before making this change to see by means of a proper study who is likely to bear the higher costs and whether they can afford them," he said.

Mr Weatherill and Mr Baird have taken the lead on the discussion about tax reform. Both have said they hope the new line-up in Canberra will reboot meaningful debate.

Mr Weatherill will tell the summit that the GST is not the big revenue generating tax the states were promised before its introduction in 2000.

He says the gap, between what the GST might have been expected to collect if it had kept pace with household income, had widened to between $11 billion and $12 billion, or about $500 a head. This is the result of changing consumption and savings patterns.

Mr Baird has argued for a GST increase to 15 per cent, as long as all households earning under $100,000 are compensated.

Federal Labor does not support any changes to the GST.

Labor state governments in Victoria and Queensland have pushed for a 2 percentage point increase in the Medicare levy to fund health.

Jay Weatherill wants finance-sector tax gap considered. PHOTO: DAVID MARIUZ

Clockwise from above: KPMG's Peter Nash; main from left, Jennifer Hewett (AFR), Mark Textor of Crosby/Textor, Michael Andrew (Board of Taxation), former finance minister Lindsay Tanner and Kate Carnell (ACCI); Michelle de Niese of the Corporate Tax Association; Michael O'Neill of National Seniors Australia; Mark Textor; economist Saul Eslake (centre). PHOTO: LOUISE KENNERLEY AND SAHLAN HAYES

Eslake takes aim at tax lurks

Concessions

Joanna Mather

Leading economist Saul Eslake said there is no public policy justification for the 50 per cent capital gains tax discount, negative gearing or the use of trusts to minimise tax.

He told *The Australian Financial Review*'s Tax Reform Summit on Tuesday that the change of prime minister provided an opportunity to re-engage in a genuine debate about reform, but lifting the GST without closing loopholes that disproportionately benefit the wealthy would not wash with the community.

Prime Minister Malcolm Turnbull had effectively put superannuation tax concessions, capital gains breaks for investors and negative gearing back into the tax reform mix. Mr Eslake said the challenge, particularly for the business community, will be to set aside "personal pecuniary or political interests".

"It's simply not right for people who want to broaden the base of indirect tax to resist broadening the base of personal income tax," Mr Eslake told the summit, sponsored by KPMG, on Tuesday.

Mr Eslake likened the tax system to a "giant Swiss cheese" riddled with holes that allow the wealthy to pay less tax, and said taxpayers in the top tax bracket are on average two-and-a-half times more likely to make use of tax minimisation strategies.

"For example, while I have no quarrel with the use of trusts to facilitate the orderly transfer of business assets from one generation of owners to the next, or to protect assets from vengeful ex-spouses or indigent offspring, I can't think of any legitimate public policy reason why trusts should also allow people to pay less tax than they would otherwise, by facilitating the transfer of pre-tax income earned by someone who would be in the top tax bracket to other people who are not," Mr Eslake said. "Likewise, the long-standing availability of negative gearing for investors in property ... has done very little – at very large cost in terms of revenue foregone – to increasing the supply of rental housing, as opposed to doing a great deal to inflate the price of the existing stock of both rental and owner-occupied housing."

But Mr Eslake has sympathy for the fact that Australia has the second-highest personal tax rate in the English speaking world. He said there was a case for axing the $18,200 tax-free threshold to lower the top headline rates of 37¢ and 45¢ in the dollar.

Cost of attracting 'footloose investment' too high

Company tax

Jacob Greber
Economics correspondent

Slashing the corporate tax rate to make Australia more competitive against low-impost jurisdictions such as Singapore, Switzerland and Britain is bound for failure because of local political and budget constraints, argues one of the nation's most experienced tax reformers.

Greg Smith, the Commonwealth Grants Commission chairman, said it made sense to reduce the corporate tax rate – arguing "25 per cent is the new 30 per cent".

However, the former senior Treasury tax official advised former Labor treasurer Paul Keating in the 1980s and working on the 2009 Henry tax review, warned that going lower would be counterproductive.

He said using the tax system to boost Australia's global competitiveness would require pushing the corporate rate below 20 per cent, which would involve too much lost revenue for governments and was likely to imply large and politically difficult increases in other areas such as the GST or income taxes.

"There's no doubt in my mind that Australia cannot chase footloose investment as its strategy," Mr Smith told *The Australian Financial Review* Tax Reform Summit in Sydney on Tuesday.

"To do that you've got to go to 15 per cent. And basically, you'll get a [economic] growth rate [lift] but you'll blow your political equation way before you get there."

By contrast, Peter Nash, chairman of KPMG, told the same discussion forum that Australia needed to do all it could to attract capital in an era where it had become ever-more mobile.

"More than at any point in time ... many countries are using their corporate tax rate as a clear and formidable economic weapon," Mr Nash said.

"They've got to have the skills and education, housing.

"But increasingly an important ingredient in that pot is the corporate tax rate that can be added to the mix to increase that investment. It's somewhat naive for us to believe we don't have to fight fire with fire," he said.

Richard Vann, law professor at University of Sydney, described a corporate tax cut as a "very blunt instrument" with which to boost competitiveness and argued in favour of a reduction of no more than a few points.

He also challenged a widespread view in the business community that Australia must bring down its relative ranking as an "above-average" corporate tax country. Professor Vann pointed out that three of the world's biggest economies – the United States, Japan and Germany – had tax rates of 30 to 40 per cent, and warned against emulating the rates of mostly small European states, or even Britain, where Chancellor George Osborne is pushing the rate to 18 per cent from 20 per cent.

> **Osborne is just turning the UK into a tax haven essentially, and I don't think that's where we want to go.**
> Richard Vann

"Osborne is just turning the UK into a tax haven essentially, and I don't think that's where we want to go," he said. Professor Vann said corporate tax cuts would also benefit Australia's "high wealth individuals ... who have all their money stuffed in trusts".

Either way, Mr Smith cautioned that Australia may not be in a position to pursue major tax reform given the size of the structural budget deficit. He said the budget was headed for significant surpluses when company taxes were cut in the late 1980s, and in the late 1990s when the Howard government introduced the GST.

"All the big tax reforms I've ever done – and I've been doing them since 1983 – have been in a very different fiscal environment than the one we have now. We have a problem, and it's heavily on the revenue side – so that's a constraint."

Mr Smith defended the current tax system, including the very "strong positive" benefits of dividend imputation, as key ingredients of Australia's success during the resources boom over the past decade.

"This tax system is the tax system of the long boom," he said. "This has made Australia one of the most robust countries in the world. It has taken us from the teens in terms of per-capita income into the top five of serious countries."

He said Australia's biggest weakness – now that the terms-of-trade boom has ended and the economy moves "into more normal times" – is the relative lack of small-to-mid-sized companies, which account for only 17 per cent of the corporate tax base.

"They are the kind of companies you're trying to stimulate [with tax changes], but from a small base."

'Innovation company' given push

Mark Eggleton talks to
David Linke
KPMG national managing partner - tax

When Prime Minister Malcolm Turnbull spoke to the media for the first time last week, he spoke of a nation of the future "that is agile, that is innovative, that is creative".

"We can't be defensive, we can't future-proof ourselves. We have to recognise that the disruption that we see driven by technology, the volatility in change is our friend if we are agile and smart enough to take advantage of it," Turnbull said.

David Linke, KPMG national managing partner – tax, says Turnbull's speech indicates he understands the challenges of the new economy.

Moreover, the nation is well placed to have a proper discussion about tax reform. Taking the Prime Minister's words into account, Linke says one particular area of potential reform is what we can do from an innovation perspective. How can we incentivise Australian start-ups and investors to expand?

In KPMG's submission on tax reform to Treasury earlier this year and followed up at this week's AFR-KPMG Tax Reform Summit, one of the key recommendations is what Australia can do to assist the growth of the nation's innovation sector. KPMG put forward the idea of an innovation company.

Linke says while Australian start-ups can often access some seed capital, there is a large gap between $2 million of capital and $40 million.

"A lot of the venture capitalists in this country talk about the 'valley of death' where you really can't get sufficient venture capital at those levels for Australian businesses to start up and expand."

Tax breaks

The basic premise is many high net-worth individuals who pay high tax rates would prefer to invest more capital into their own company than necessarily pay more tax. The key here is to use this desire to invest more in their company to the innovation sector's advantage.

Put simply: investors can inject capital into an innovation company and the investors can access the losses earlier.

"You're basically using the federal tax system as an incentive to put capital into the start-up and innovation community and build new businesses," Linke says.

"The UK has something whereby if you put money into a particular type of fund, you'll get a tax deduction.

"We don't think that's the right way to go, we think you're better off backing a particular company; choosing which particular business you want to invest your money in, but then accessing those tax benefits which are often trapped in those companies earlier. It's not about the government picking the industry as it's hands-off completely in the whole process. The government's role is to give a concession only."

Picking winners and trying to support ecosystems in a particular area is fraught with difficulty and there are numerous instances where governments have failed in this area.

The beauty of the innovation company is it's a specific tax concession for companies, which are designated as innovation start-ups where you can utilise the tax loss if you are an investor.

And for Linke, this is the key to Australia becoming a more agile and dynamic economy.

"We need to assist more Australian entrepreneurs to engage in start-up enterprises."

> *A lot of the venture capitalists in this country talk about the 'valley of death' where you really can't get sufficient venture capital at those levels for Australian businesses to start up and expand.*
> David Linke, KPMG national managing partner - tax

Small businesses

Beyond innovation, Linke mentions the need for a complete rethink about how we tax small business. It needs to be simplified and the inherent complexity of Australia's system needs to be reduced as it's currently a drag on the economy.

"Reducing that complexity will provide a benefit to the overall economy. We often talk about start-up success and how small business has to be nimble and agile but it's hard in the current trust tax system."

For Linke, fundamental reform of Australia's tax system goes to the heart of Australia's transformation into a modern, innovative digital economy.

"Now is an ideal time to talk about it because we have a new leadership team.

"It's going to cost a bit in the short term and some of the discussions we have had around the country is most people think it's OK to go into deficit to fund a structural change in the tax system.

"Ultimately, it will drive greater economic growth and therefore it will be better for the nation overall."

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Foreign investors use ‘equity as debt’

Multinationals

Neil Chenoweth

The government has declined to close a loophole that allows foreign investors to use “equity described as debt” to ensure they are taxed at zero or at most 10 per cent, Sydney University Challis law professor Richard Vann told *The Australian Financial Review* Tax Reform Summit in Sydney on Tuesday.

In a spirited exchange on tax rates, the chairman of the Commonwealth Grants Commission, Greg Smith, said Australians owned more investments in the rest of the world than the rest of the world owned in Australia.

This apparent discrepancy was because foreign investors pumped their Australian holdings full of borrowings rather than equity.

“We don’t tax foreign investment in Australia because it’s all debt,” Mr Smith told the event, hosted by *The Australian Financial Review* and KPMG.

“Debt disguised as equity,” Professor Vann said.

Interest payments generally attract only 10 per cent withholding tax.

Professor Vann said there was a loophole in the “thin cap” provisions, which limit the level of debt that foreign companies can hold in Australian subsidiaries.

The government had moved to tighten the rules “but also there is a let-out that will increase it being used,” he said. “The government has decided not to close the let-out.”

Left to right: Dr Andrew Leigh, Mark Konza and Dr Mark Zirnsak at the tax summit on Tuesday. PHOTO: SAHLAN HAYES

Singapore’s 15 per cent tax rate was a recurring theme throughout the day.

While both Mr Smith and Professor Vann argued that corporate tax should be reduced, they and Business Council of Australia chief economist Lisa Gropp were opposed to moving the tax rate below 25 per cent.

“We don’t want to go down the UK route,” Professor Vann said. UK Chancellor George Osbourne, who has announced rates would go to 18 per cent “is just turning the UK into a corporate tax haven”.

KPMG chairman Peter Nash was less averse to a Singapore-level tax rate. “It’s somewhat naive to think we don’t have to fight fire with fire,” he said.

The marvellous part about tax forums is the way it brings people *together* – and by together we mean BHP Billiton’s head of tax, Jane Michie, sharing a stage with three of the people least likely to be on her Christmas card list.

It’s not that she has anything against Deputy Tax Commissioner Mark Konza, Tax Justice Network’s Mark Zirnsak or shadow assistant Treasurer Andrew Leigh – and clearly she retained all of her fingers and toes at the end of the session.

“I’m delighted to have the opportunity to talk about Singapore,” she said, before detailing the $65 billion in tax and royalties BHP Billiton has paid in the last decade. “That is a lot of money,” she said.

In 2014 BHP Billiton earned $16 billion from Australian production. “We paid tax on every cent. In Singapore we made $US1 billion. That gives you a sense of the proportionality.”

Some 58 per cent of its Singapore earnings were taxed under Australia’s CFC laws.

Mr Konza declined to comment on the Tax Office’s ongoing audit of BHP Billiton’s Singapore marketing operation and pointed to an endemic threat from marketing hubs.

“We have 24 audits under way at the moment of hub operators and we are going around trying to verify they do what they say they do,” he said.

Mr Konza said in 40 years of tax work he had not heard references to Marx, but that companies were now emphasising the value of their labour.

“They are telling us, ‘We believe our labour is worth more than just a cost-plus basis’,” he said.

Mr Zirnsak said the Justice Network took a moral approach to taxation because unequal treatment for some companies was unfair.

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