

Tax Reform Summits

KPMG update on the
tax reform debate

30 September 2015

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National Reform Summit

Prime Minister Malcolm Turnbull has recognised the importance of common ground being reached on economic and social policy at two major reform summits held in Sydney in August and September 2015.

The first was the National Reform Summit held on 26 August 2015 and hosted by KPMG. Here, the major leaders of our community - business, social services and the trade union movement – got together in an effort to find consensus and to map a route forward in terms of reform.

The new Prime Minister has described the summit, sponsored by The Australian, The Australian Financial Review and supported by KPMG, as “A rare opportunity to achieve consensus on the most pressing economic and social reform issues” facing Australia. “I want to build on the key priorities of the summit and work towards a practical set of reforms that will help to create jobs, drive innovation and stimulate growth,” Mr Turnbull said.

The nine tax reform principles established at the National Reform Summit (outlined in the table below), call for action on key issues such as returning the budget to structural surplus over time and lifting productivity.

The Prime Minister has invited key proponents from the National Reform Summit including business, union and community leaders for direct talks at Parliament House on 1 October 2015 as he formulates the government’s reform agenda.

The tax reform principles formed a solid platform for a deeper analysis at the second Summit held in Sydney on 22 and 23 September 2015, the AFR Tax Reform Summit, which was sponsored by KPMG.

Between these two important summits the Liberal Party elected a new leader on the evening of 14 September 2015. Malcolm Turnbull was sworn in as the 29th Prime Minister of Australia on 15 September. On 21 September, Scott Morrison and Kelly O’Dwyer were sworn in as the 39th Treasurer and 12th Assistant Treasurer respectively. The Assistant Treasurer was also sworn in as the 16th Minister for Small Business and is one of the 21 members of Cabinet.

These summits gave rise to a new optimism for the scope and prospects of reform. Following his election as leader of the Liberal Party, Malcolm Turnbull’s first speech outlined his vision for Australia.

Malcolm Turnbull said his government would be, “Focused on ensuring that in the years ahead as the world becomes more and more competitive and greater opportunities arise, we are able to take advantage of that.

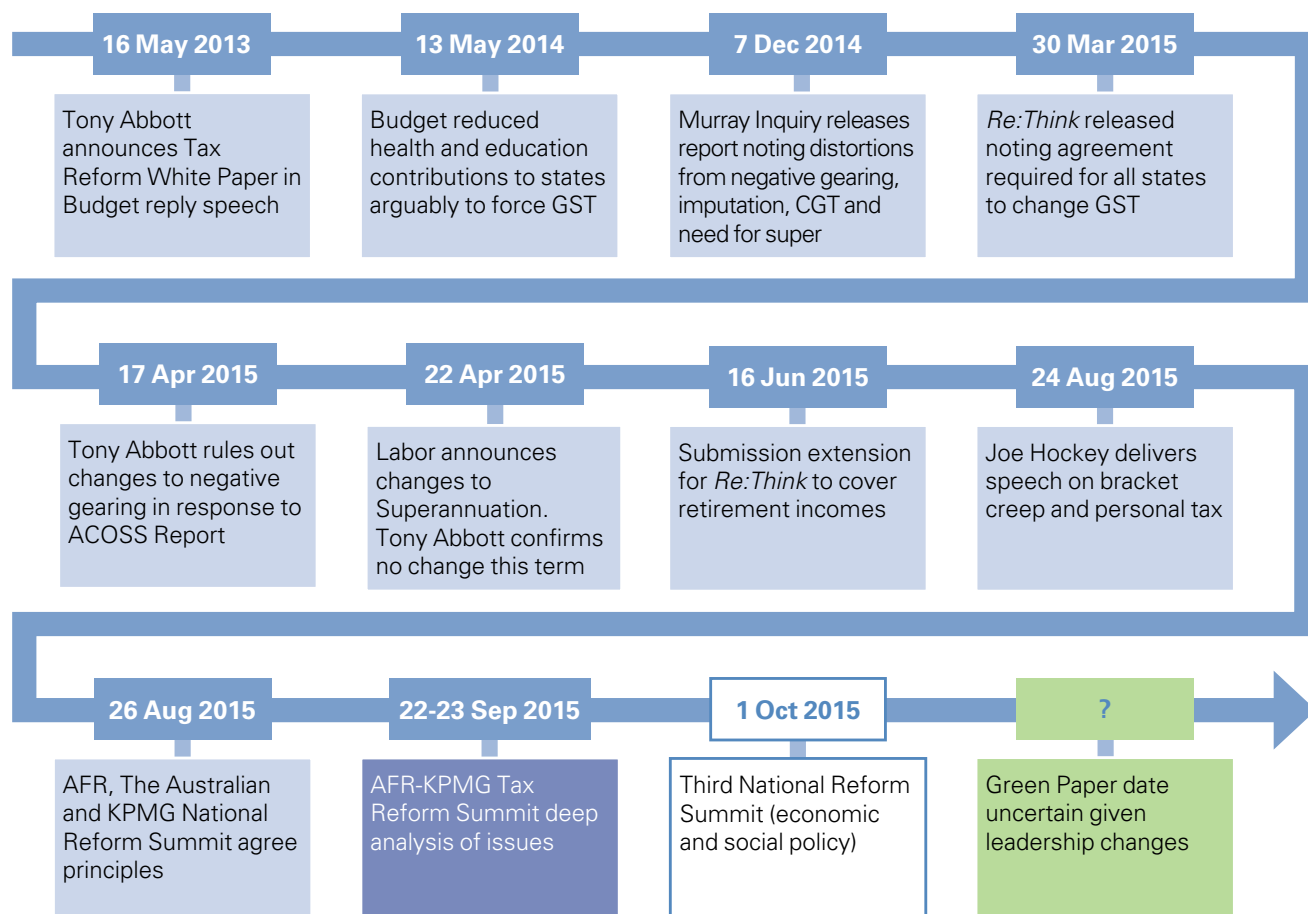
The Australia of the future has to be a nation that is agile, that is innovative, that is creative. We can’t be defensive, we can’t future-proof ourselves.

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.”

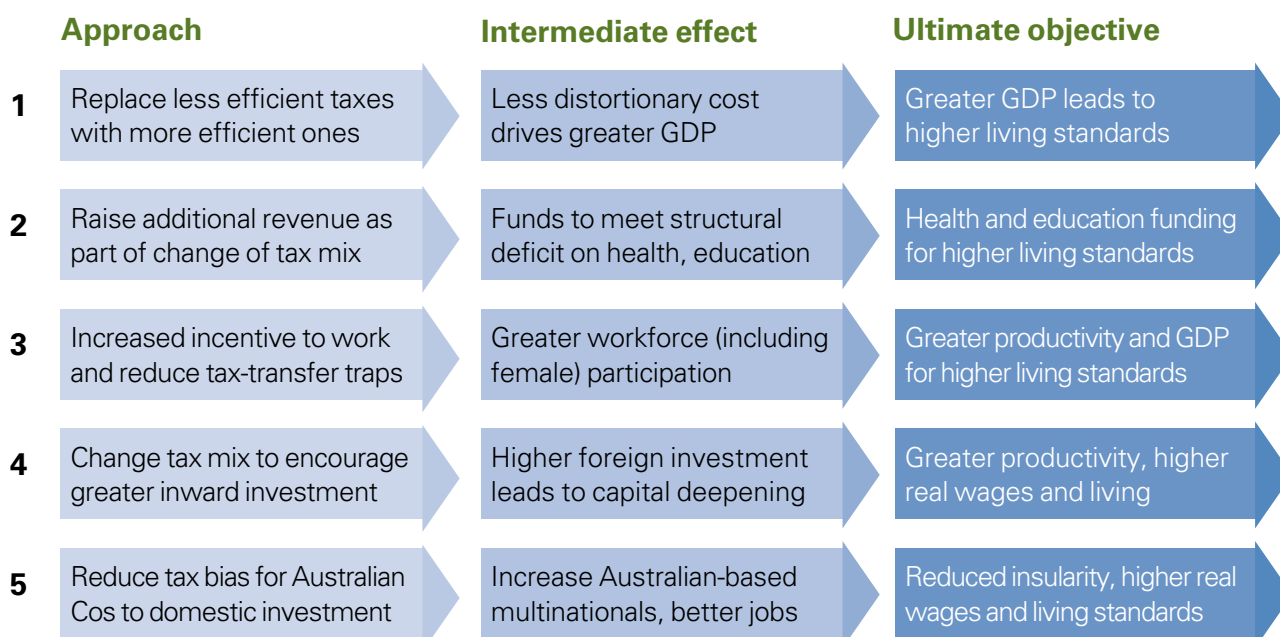
The nine tax related principles of the National Reform Summit are listed below

1. Remain open to looking at the tax system as a whole and consider all options
2. Any reform must ensure the majority of households, particularly the low-income households, are no worse off
3. Consider the interactions of personal tax rates and transfer system taper rates, particularly for lower income women, and their impacts on workforce
4. Different sources of individual investment income should be taxed as consistently as possible (eg. capital gains and related deductions)
5. A competitive corporate tax system
6. Where the corporate tax system does not keep pace with community norms, governments need appropriately balanced regulatory responses
7. Greater reliance on land tax
8. Inefficient taxes (eg. insurance and conveyance duties) replaced with more efficient, uniform taxes as part of a broader reform
9. The best starting point is to design a robust, fair and efficient tax system. Revenue distribution arrangements across the Federation should follow

Timeline of the current Tax White Paper process



Objectives of tax reform





AFR-KPMG Tax Reform Summit

Key themes

A number of general themes arose at the Summit which go beyond specific taxes.

Bi-partisanship

The Summit wrestled with the issue of bi-partisanship when it comes to social and economic policy and reform. It was recognised that this was an impossible ask. Indeed leading pollster and researcher, Mark Textor said, "For years I have heard business say we need bipartisanship. We have an adversarial system – harden up, get over it, it's not going to happen." The Hon Lindsay Tanner, former Federal Finance Minister, went further, "Bipartisanship is the enemy of accountability."

It should be noted that our two great periods of tax reform – 1985 and 1998-99 did not involve bi-partisanship.

Engagement with the community

One thread throughout the conference concerned the need to obtain community buy-in on tax reform. This was seen as very difficult in circumstances where the dangers of failing to reform appear to be down the track. Phil Edmonds, Managing Director of Rio Tinto Australia, pointed out the importance of engaging at the grass roots. He noted that with the 'recognise campaign' a series of community conventions are planned. He also said, "We need interlocutors the community can trust. Even with greater understanding of the issues, each community sector will look to its own representatives for assurance."

Delegation of tax reform to an independent body

There have been a number of calls for an Independent Tax Authority. Mark Carnegie, founder of MH Carnegie & Co, said that the government should tell an Independent Tax Authority how much revenue to raise and that body should raise such revenue in the most efficient manner possible. Many however, felt that this encroached upon our democracy. KPMG has suggested that an independent Tax Reform Compensation Commission – with three members elected by a two thirds majority of both houses of Parliament - to determine the appropriateness of compensation once the shape of tax reform has been established. This, however, is very far from having a non-elected body determine the shape of our taxation.

'Of course-ness'

In 2011 at a presentation to the October Tax Forum, Dr Ken Henry gave his reflections on the difficulties of tax reform. He said:

"Good policy outcomes are much more difficult to secure where visionary ideas, big challenges and creative approaches are floated for the first time in the announcement of a policy decision.

A better outcome will usually be achieved when the visionary idea is so well accepted that it seems banal; where the challenges are so broadly accepted that everybody is worried sick by them; and when approaches to dealing with those challenges appear merely natural."

This leads one to surmise how readily accepted are tax reform ideas in the realm of tax experts, leaders and the community at large. How banal is the debate, not because of its subject matter, but because a significantly large portion of the community would reply 'of course' to an assertion. This 'of course-ness' test is an important one to determine where certain reform measures fit in the tax reform debate.

In 1985, most reasonable thinkers would have said that we needed a capital gains tax system, a more effective mechanism for dealing with fringe benefits and a lower company tax rate with a mechanism for reducing double taxation. Although these measures did not receive bi-partisan political support, most would have treated the logic behind the reform measures with an acquiescent 'of course'.

Similarly, advocating a goods and services tax (GST) to replace a wholesale tax system had the requisite level of 'of course – ness' even though it was politically contentious. Australia had put the wholesale sales tax in place in the 1930s because it was a hidden tax and hence more politically palatable. By the 1990s we were one of the few countries with such an outdated system which we shared with Botswana, Ghana, Swaziland and the Solomon Islands.



AFR-KPMG Tax Reform Summit Poll

In seeking to determine the degree of consensus at the conclusion of the AFR-KPMG Tax Reform Summit we conducted a poll. Participants were asked to rank certain objectives of tax reform. The primary objective to tax reform was ranked by participants in the following way, as outlined in the table below.

Primary objective	First priority	First or second priority
Raise additional revenue to solve structural deficit	36%	59%
Replace less efficient taxes to increase investment	36%	57%
Increase incentive to work and reduce transfer traps	20%	49%
Increase equity through redistribution	8%	51%

Participants were additionally asked to give high, medium or low ranking to seven items based on four criteria:

1. The weight they would give the items themselves
2. Their perception of the weight that would be given by current leaders in the community
3. The current level of community buy-in
4. The potential for community buy-in.

The results for combined medium and high rankings are listed in the table below.

Medium or high ranking	Participant's weight given to item	Perception of		
		Current leaders	Current community buy-in	Potential community buy-in
Eliminate bracket creep	69%	80%	80%	98%
Broaden personal tax base	74%	50%	68%	84%
Reduce super concessions	88%	88%	83%	96%
GST increase rate	80%	63%	25%	79%
GST broaden base	78%	59%	14%	63%
Land tax for stamp duty	89%	72%	43%	73%
Reduce company tax	51%	79%	23%	69%



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Observations on the relative consensus for individual taxation measures

GST base and rate

While there is significant acceptance for an increase in the GST base and rate in those close to the tax reform discussion, this does not yet extend to the current community. That said, most believe there is a potential for community acceptance.

There are two polarising areas which need to be thought through and debated with deeper research.

The first concerns the regressivity of the GST. Some assert it is highly regressive and others question this. We clearly need more empirical work in this area. The Organisation for Economic Co-operation and Development (OECD) in a recent report titled *The Distributional Effects of Consumption Taxes in selected OECD Countries 2014* looked at 20 VAT/GST systems throughout the world. Unfortunately Australia was not one of them. The report says:

“The results therefore challenge the general public perception that VAT systems are regressive, at least in a lifetime context. That said, results for Estonia, New Zealand and the Slovak Republic highlight that broad-based systems that few have reduced VAT rates or exemptions can still produce a small degree of regressivity when expenditure is used for lifetime income.”

The second concerns the efficiency of the GST. The government’s tax discussion paper, *Re:think*, makes a comparison between the marginal excess burden of GST, which is said to be 19 percent, and personal income tax which is said to be 21 percent. The basis for each of these rates involves some simplistic assumptions. In particular the transfer system is not taken into account which produces some very distortionary behaviour for income tax. Moreover the equity need for some compensation for the GST would need to be properly modelled for a meaningful comparison of the efficiency of the two taxes. Again more work needs to be done before a consensus can build. In addition, Treasury modelling seems to be out of kilter with some private enterprise modelling and the differences need to be unpacked and discussed.

Broaden the personal tax base

Possibly this means different things to different people, but limiting deductions on negatively geared properties appears to be a main point of focus. This, for many participants, is a major community concern currently. There was a sense by participants at the Summit that leaders in the tax debate underrate its importance.

Superannuation concessions

There seems to be a consensus forming that top-end superannuation concessions need to be reviewed. The consensus seems to be around the general concept rather than the specifics: whether there should be lifetime caps, different pre-tax contribution limits and whether taxation should exist in the retirement phase on earnings.

There appears to be growing consensus that these should be considered in light of the objectives of superannuation.

Company tax

There would appear to be a consensus forming that lowering the company tax rate to something between 25 percent and 28 percent is a good idea in the long term, but not necessarily in the short term, given our current international environment. There is recognition that lower company taxes leads to higher real wages in a small open economy, but there is a significant question as to how much of this benefit flows through to employees. Again more empirical work is required.



Land tax for stamp duty

Nearly 90 percent of participants thought this was a good idea given the inefficiency of stamp duty. On the other hand more than half of the participants thought there was low community buy-in at this stage. The three main issues raised here are:

- Transitional equity issues for those who have recently purchased
- Imposing the burden on the family home
- Cash-flow issues for those not on standard earned incomes.

Solve bracket creep

There was no clear consensus on bracket creep. Two observations are often made. Firstly, we are at a low point in wage inflation so that bracket creep is currently not high by historical standards. This is true, but does present the opportunity for less costly change. Secondly, many feel that politicians will never give up the right to reduce the tax rate and thresholds given the political benefits that these generate.

Emerging issue – innovation

With the new Prime Minister instantly putting innovation at the fore of his thoughts, the tax reform focused community is asking whether we have our policy settings right in this area.

The innovation sector is an unusual one. There are a high number of failures for each success. But the successes can be substantial. Importantly, we are experiencing some relocation of innovative businesses overseas in search of additional funding.

One of KPMG's 60 recommendations in our tax reform submission to Treasury was for a new innovation company, which would monetise tax losses and hence attract investment from high net worth individuals. This would help address the funding problems at the \$2 million to \$40 million from which many start-up companies suffer.

Next steps

The Turnbull Government has announced that a Green Paper on tax reform will be released in the coming months. This is consistent with the timetable announced by the Abbott Administration. There is speculation, however, that the timing may be early next year given the Prime Minister and new Treasury ministers take stock of where we are at in the process.

Three things seem clear. Firstly, for successful tax reform the Prime Minister as well as the Treasurer needs to be fully supportive and to argue the case with coherence, deep understanding and eloquence.

Secondly, it would seem that any new reform proposals are likely to be debated fully within the Turnbull Cabinet as part of the new Prime Minister's public commitment to 'traditional government.'

Thirdly, we are a long way from where we were in July 2015. Our major leaders of our community - business, social services and the trade union movement - have sought and found areas of consensus, our new government has sought to put all issues on the table and there is a sense of optimism about reform.



Appendix

Tax reform evaluation principles

Content from KPMG's publication: **Tax Reform Summit - background notes and issues for consideration**

1 Efficiency	Economists generally measure efficiency in terms of 'excess burden', that is the burden in excess of the direct burden on the taxpayer. Taxes with low rates and a broad base tend to have lower excess burdens. KPMG estimates that GST has a low marginal excess burden of approximately 7 percent compared to company tax of nearly 40 percent. The main question is what weight one gives to efficiency.
2 Equity	One can consider the level of regressivity or progressivity of a particular tax or the equity of the tax and transfer system as a whole. Other equity issues concern wealth vs income inequality. Also the impact on urban vs rural communities (eg. fuel excise and congestion charging.) Deficit budgets present issues of intergenerational equity as they are effective borrowings from future generations.
3 Simplicity	The Australian tax system is considered very complex both relative to the size of the economy and in absolute terms. Carve-outs and exceptions tend to diminish the effectiveness of a tax and certainly add to the costs of compliance. It may be best to have a comprehensive base and compensate for disadvantage in other ways.
4 Sustainability	A budget clearly must be sustainable in the long term. But this is area is complex: the extrapolation of small differences can produce staggering numbers and there is uncertainty about the future of the global economic environment. If the level of net debt as a percentage of GDP crosses a certain bar, the consequences can be substantial. That bar is seen to be lower for small to medium-size countries.
5 Consistency	Constant change to the tax system diminishes trust, carries additional compliance burdens and generates its own inequities as people act on the basis of a certain set of rules. A lack of consistency can also be an impediment to foreign investment. The question is raised most commonly in the context of superannuation which intrinsically involves a long term considerations.
6 Transparency	Much of our budgetary information, say in relation to State-Federal revenues and expenditures, and the extent of bracket creep, are currently relatively opaque, certainly to the general population. Transparency may drive efficiency benefits as people ponder different revenues and expenditures in different states or the extent of the additional tax paid through bracket creep.
7 Stability	To what extent should revenue and expenditure targets take into account the economic cycle? Also does the tax mix contain an appropriate level of taxes that act as automatic stabilisers, such as company taxes or capital gains taxes, and less volatile taxes such as payroll and consumption taxes.
8 Gender equity	Greater female participation may give rise to huge productivity gains in Australia. Our tax system needs to be considered through a gender prism. Questions arise as to whether it is appropriate to use family or joint income in the transfer system and the taxation treatment of childcare.



Federal – State relations

Content from KPMG's publication: **Tax Reform Summit - background notes and issues for consideration**

1 Vertical fiscal imbalance – a solution?	<ul style="list-style-type: none"> • Highest amongst the major federations – USA, Germany, Canada • Unlikely to be solved without allocating a portion of income tax rights to states (revenue sharing or state tax surcharge) or a major reallocation of responsibilities from the states to Federal Government (eg. indigeneity and education) • On income tax, if states had ability to change rates and base it would present equity issues and complexity • The equity issue is that lower wage and lower participation states would need to levy heavier taxes to raise the same per capita revenue. This may escalate as people moved from higher taxed poorer states to lower taxed richer states
2 Horizontal fiscal equity	<ul style="list-style-type: none"> • There is an inherent tension in a federation: on one level it is a shared vision, with common welfare and security; yet there is a desire to protect regional diversity and autonomy • Current formula for allocating federal funds to states by the Commonwealth Grants Commission has been criticised as complex, without providing sufficient certainty for states • Generally not considered possible to allocate GST on a per capita basis without additional funding for Northern Territory, South Australia and Tasmania. Would this simply be a form of 'de facto' HFE and improve the current position?
3 Efficiency driven by transparency	<ul style="list-style-type: none"> • Could all government accounts which show different state per capita spends on health etc drive greater efficiency through transparency?
4 Efficiency funding formulas	<ul style="list-style-type: none"> • Could efficiency funding formulas, properly conceived, be the main basis for state expenditure productivity improvements?
5 Single revenue collector for all taxes	<ul style="list-style-type: none"> • Are there significant gains for business and individuals from a single Australian tax collector? Dealing with multiple agencies is a costly irritation for business. Also greater efficiency gains though data matching and prefilling tax returns.



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