Tax Reform White Paper process begins with release of discussion paper

30 March 2015

Why do we need tax reform?

On 30 March 2015, the Federal Government released a tax discussion paper *Re:think, Better tax system, better Australia* (the Discussion Paper), which formally starts the process for developing the White Paper for Reform of Australia's Tax System (the Tax Reform White Paper).

The aim of the Discussion Paper is to foster an 'open and constructive conversation with the community on how we can create a better tax system that delivers taxes that are lower, simpler, fairer'.

The aim of the Discussion Paper is to foster an 'open and constructive conversation with the community on how we can create a better tax system that delivers taxes that are lower, simpler, fairer'

This goal of a better tax system is a means to an end. The Discussion Paper emphasises that 'tax reform offers one of the biggest opportunities to improve productivity and foster jobs, growth and opportunities'.

The broad narrative underpinning the Discussion Paper's claim for tax reform will not be particularly surprising for those who have followed the speeches of Treasury officials over the past few years or read the recently released 2015 Intergenerational Report (IGR).

The Discussion Paper understandably focuses on the need for tax reform in order to be able to respond to:

- Globalisation - international mobility of capital and people means that it is imperative for our tax system to be competitive in order to attract investment and foster globally competitive businesses
- Australia's declining productivity growth – improved productivity is underpinned by innovation and is the key to delivering higher wages and living standards
- an ageing population and shrinking workforce relative to retirees – this was the major theme of the IGR and brings into focus the need to address long term savings and encourage greater workforce participation.

The current tax arrangements are hindering the ability of Australian governments and businesses to respond effectively to these challenges.

In setting the scene for consideration of specific taxes the Discussion Paper makes mention of a series of tax-related problems that may need to be addressed, including:

- Australia's heavy reliance on income taxes, particularly company income tax, compared to other developed countries and our Asian competitors
- the economic burden created by reliance on inefficient taxes, and particularly company income tax and stamp duties
- the complexity and compliance of the current tax system, specifically noting that tax compliance costs are in the order of $40 billion per year
- that high effective tax rates resulting from the strongly progressive nature of our tax system, exacerbated by bracket creep, can reduce workforce participation incentives for some groups, and
- distortions in the taxation of alternative savings vehicles affects savings choices.

A good tax system raises the revenue needed to finance government activities without imposing unnecessary costs on the economy. That is, tax reform is about how revenue is raised, not just about how much.

However, somewhat surprisingly, the Discussion Paper places little emphasis on the long term fiscal challenges highlighted in the IGR - the word 'deficit' does not appear anywhere in the document. Indeed, the mantra of a system that delivers 'lower, simpler, fairer' taxes suggests that greater fiscal restraint will be needed by future Commonwealth governments. While on face value this may bring with it electoral support, it is a challenging message for a community that has increasing expectations regarding the services that governments are to provide in relation to education, health and infrastructure.

Finally, the Discussion Paper asks ‘Can we address the challenges that our tax system faces by refining our current tax system? Alternatively, is more fundamental change required, and what might this look like?’

This question highlights the nuance between ‘refinements’, which could mean piecemeal change, versus ‘fundamental change’, which could be interpreted as comprehensive reform. The Discussion Paper provides few pointers as to breadth of any future tax reform package, probably leaving this for the next discussion paper.

However, PwC is of the view that a process such as this should:

- encourage a comprehensive assessment of all taxes, and
- generate an outcome that goes beyond ‘tweaks’ to a few taxes, and instead provides a clear road map for recasting and improving the tax system for the next 35 years – this is the time to be bold.

Overview of the Discussion Paper

The Discussion Paper, *Re:think, Better tax system, better Australia*, provides a comprehensive summary of Australia's tax system in over 200 pages, and poses 66 questions ranging from the challenges and priorities of tax reform generally, to specific questions on particular issues.

We have provided a summary of the key points and issues raised in the Discussion Paper under the following broad headings:

- Personal tax
- General business tax
- Small business
- Indirect taxes
- Local and State / Territory taxes
- Not-for-profit, and
- Governance and administration.

Personal tax

The taxation of individuals is a significant source of revenue for the Federal Government, comprising almost half of all income tax receipts. It principally comprises income tax (including capital gains tax (CGT) and Fringe Benefits Tax (FBT). A range of issues relating to the taxation of individuals and the challenges of balancing their competing objectives are canvassed in the Discussion Paper, including the progressivity of the current system, bracket creep, the potential for the tax system to act as a disincentive for workforce participation, and its effect on labour force mobility.

Tax receipts from individuals comprise almost half of all income tax receipts

From a personal tax perspective, a key focus of the Discussion Paper is on the taxation of domestic savings, which is a contentious area as the current tax arrangements differ between different types of savings. Domestic savings broadly refers to investments in:

- cash (that is, bank accounts and debt-like instruments)
- investment properties
- owner-occupied properties
- superannuation, and
- investment in domestic and foreign shares.

There are wide ranging views as to how these different forms of savings should be taxed. Specific issues raised in the Discussion Paper include:

- the CGT discount as it applies to gains from shares and investment property
- the impact of dividend imputation on savings decisions (see also *General business tax* below for further discussion of the dividend imputation system), and
- negative gearing in relation to investment property.

The Government has effectively ruled out changes to the CGT exemption for owner-occupied housing, stating that 'Given the central importance of the home for Australian families, there is a strong consensus that it would not be appropriate to tax either the imputed rent on owner-occupied housing or capital gains derived from it'.

Changes to the taxation of savings were a key recommendation from Australia's Future Tax System Review (Henry Review), which was released in 2010. The Henry Review recommended a 40 per cent discount for tax on savings including interest income (non-business related), residential rental income, dividends and capital gains, which was rejected at the time by the then Government. This area is likely to be a focus of any future reforms to the tax system, and has linkages with the White Paper on Reform of the Federation (Federation White Paper) which is currently under development.

Superannuation

Whilst there are policy grounds for superannuation being taxed at a lower rate than labour income, the Discussion Paper notes that there are issues around the distribution of the impacts and their effectiveness in supporting higher retirement incomes, as well as their complexity.

The Discussion Paper notes that the different rates of tax on earnings in the pre- and post-retirement phases are considered to add costs to the operation of the superannuation system. They also give rise to tax planning opportunities that are usually more accessible to high income earners. With Australia's ageing population, more individuals will enter the retirement phase where no tax is paid on earnings in superannuation funds. This will put pressure on the long-term sustainability of the superannuation tax arrangements, particularly given other long-term budgetary pressures as the population ages, such as calls for higher spending on health and aged care, and relatively lower revenue from personal income taxes.

The rates of tax on superannuation contributions mean that high income earners can access a larger tax concession, relative to their marginal tax rate, than low income earners. The same may be true during the accumulation phase and also during the retirement phase where there may be no tax on earnings.

The Financial System Inquiry made observations relating to the differential tax rate on earnings across the accumulation and retirement phases, as well as the targeting of superannuation tax concessions. The Government has indicated that these will be considered as part of the Tax Reform White Paper process.

The issues highlighted in the Discussion Paper should provide an opportunity for reformulation of a policy framework for personal tax. However, PwC is of the view that it is important that all aspects of the taxation of savings be within the scope of the Tax Reform White Paper process, including any impact on investment decisions. When comparing the tax characteristics of different types of savings, a holistic approach is needed to achieve appropriate outcomes.

General business tax

Reform of the business tax system is by necessity a complex undertaking due to the many competing objectives and desired outcomes. The Discussion Paper makes the following observations which are important in having a discussion around what a reformed business tax system might look like:

1. Tax is becoming increasingly important as Australia competes for foreign investment and businesses become more globally mobile.

2. A more competitive business tax environment would encourage higher levels of investment in Australia which can lead to increased employment and wages.

3. The dividend imputation system ensures there is no double taxation on Australian profits earned by Australian companies owned by Australian shareholders and supports the integrity of the business tax system but it makes little contribution to attract foreign investment into Australia.

4. Australia's corporate tax system is complex and it can create unintentional biases towards particular forms of investment and distort business decisions.

5. The tax system can seek to encourage business innovation.

The corporate tax rate

As expected, the Discussion Paper addresses the long-standing issue of reducing Australia's corporate income tax rate based on Australia's comparative standing as a high corporate tax jurisdiction. It provides considerable comparative analysis as to the extent of revenue contribution of corporate taxes to both regional economies and other major OECD countries. A clear emphasis is placed on the extent to which Australia relies upon corporate income tax as a revenue generator and the consequential burden placed on Australian companies and shareholders.

The analysis is broad and the Discussion Paper identifies wider implications of a high corporate tax rate, including:

- exacerbating the desire for organisations to participate in complex tax structuring
- incentivising Base Erosion and Profit Shifting (BEPS) away from high tax jurisdictions
- encouraging aggressive debt loading and associated thin capitalisation abuse, and
- identifying the burden of high corporate tax rates as falling on employee, shareholder and consumer stakeholders.

The Discussion Paper also presents a clear argument as to the adverse consequences of high comparative corporate tax rates on economic growth and living standards, with a particular emphasis as to the adverse impacts upon both domestic, and in particular foreign, investment.

Overall, the comments in the Discussion Paper on the corporate tax rate seem clearly intended to establish a case for a reduction

Overall, the comments in the Discussion Paper on the level of the Australian corporate tax rate in Australia seem clearly intended to establish a case for a reduced corporate tax rate. The Discussion Paper stops short of proposing this, but poses the somewhat rhetorical question as to whether the corporate tax rate should be dropped in order to encourage investment and follow the trend of other major developed economies.

The arguments put forward in favour of a rate reduction are well established and do not contribute substantively to the long-standing debate on the need for a rate reduction. Importantly, the Discussion Paper disappointingly fails to provide sufficient analysis as to how such a reduction in corporate tax rates might be effectively funded. Given a reduction in corporate income tax rate would likely reduce Commonwealth revenues, an important aspect of the debate should be consideration of how such a rate reduction might be funded. Whilst the Discussion Paper provides anecdotal comments on anticipated economic growth arising from reduced tax rates and a consequential broadening of the tax base, the analysis appears insufficient to appropriately consider compensating for loss of revenue.

Dividend imputation system

The Discussion Paper raises the question of whether the current dividend imputation system continues to serve Australia well in the context of an ever increasing global economy with foreign investment into and out of Australia. The Paper notes that the current imputation system, while addressing some biases in the tax system and providing some form of integrity, still creates a bias against Australian-owned companies investing in foreign companies or foreign operations, and for Australian investors who have an incentive to invest in Australian shares rather than other investments. In the context of its effect on foreign investment in Australia, because there is no imputation credit allowed to foreign residents for Australian company tax paid, the design of the imputation system may not help attract new investment into Australia. The imputation system is also said to reduce the effectiveness of tax concessions such as the research and development (R&D) incentive and comes at the cost of increased complexity of the tax system.

Tax in a globalised world

Multinational tax avoidance or BEPS is an issue affecting Australia's corporate tax base, despite the extent of its impact being relatively unknown. The Discussion Paper maintains that Australia already has some strong integrity rules to deal with BEPS (e.g. general anti-avoidance rules, strong transfer pricing rules, recent reforms to thin capitalisation and tax transparency), leaving open the potential for the rules to be further tightened.

The Discussion Paper reiterates that the two-year G20/OECD BEPS Action Plan will be completed by December 2015. However, the Paper does not raise any specific questions for consideration as to whether Australia should ultimately adopt the OECD's final recommendations on BEPS.

The Discussion Paper acknowledges that lowering Australia's company tax rate below 30 per cent would discourage companies from engaging in profit shifting and tax avoidance activities.

The varying tax outcomes on the different forms of income sourced in Australia for foreign investors are outlined in the Discussion Paper. The differing tax treatment and the different types of vehicles being used by foreign investors adds to complexity in the tax system and raise questions about the extent to which it is desirable to provide a more attractive tax environment for globally mobile investments. The Discussion Paper acknowledges the reports by the Australian Financial Centre Forum (the Johnson Report), the Financial System Inquiry and the Board of Taxation on collective investment vehicles and indicates that Treasury will be consulting with industry in coming months to develop proposals for inclusion in the forthcoming Green Paper.

Australia's treatment of foreign income attributed to outbound investments and whether the tax treatment distorts investment decisions is also explored. Reading between the lines, this could reopen the issue of whether Australia's controlled foreign company rules should be reviewed.

Research & Development

Encouraging more business innovation is one of the four ambitions of the Government's Industry Innovation and Competitiveness Agenda, and the R&D Tax Incentive is the primary mechanism by which the Government seeks to encourage companies to undertake R&D activities in Australia. The Discussion Paper reaffirms the critical importance of innovation to Australia's future and acknowledges that the R&D Tax Incentive Program is a vital mechanism of support for R&D across the nation. It also confirms that the Government will review the operation of the R&D Tax Incentive as part of this Tax Reform White Paper process.

Other general business tax issues

The Discussion Paper also canvasses a range of other business tax issues including:

- whether the tax system can provide a more neutral treatment of the various forms of financing business investment through debt, equity or retained earnings
- tax depreciation of capital assets and the tax treatment of expenditure on creating or acquiring various forms of intangible assets (e.g. goodwill) as a relevant issue affecting business investment and costs of compliance
- whether the tax treatment of losses discourages risk-taking and innovation and hinders business restructuring (although noting that the tax treatment of losses was previously explored by the work of the Business Tax Working Group in 2012)
- the historical question of whether accounting and tax concepts could be aligned to potentially reduce complexity and compliance costs in the tax system
- the circumstances in which specialised industries, such as agriculture and life insurance, should be subject to special tax provisions against the backdrop of a fair and simple tax system, and
- the distinction between revenue/capital in the tax law and the differing tax outcomes it creates as between domestic and foreign investors.

Small business

The Discussion Paper acknowledges that Australian small businesses are numerous, diverse and make an important contribution to the Australian economy and against that backdrop raises a number of characteristics of the tax system that may impact them and their owners. The Discussion Paper does not strictly define the term 'small business', although it does acknowledge that most small business are family businesses where one person can simultaneously be the owner, manager, employer and employee.

The Discussion Paper focusses on the legal structures adopted by Australian small businesses - sole trader, partnership, trust, corporation or a combination of these. It notes that the different tax treatment of different legal entities, and the ability of a small business owner to navigate this complexity, can have a significant effect on a business' tax liability, and can lead to different tax outcomes for economically similar activities.

Flow-through entity for small business?

One alternative raised in the Discussion Paper as an option to decrease overall complexity and costs for small business is the introduction of a flow-through tax entity similar to the 'S-Corporation' which is currently used in the United States of America. S-Corporations generally offer the benefits of reduced establishment costs and complexity, limited liability and tax treatment similar to a partnership, including for tax losses. However, the tax treatment is not as favourable as a discretionary trust as there is only limited ability to choose which taxpayer is liable for tax on the profits of an S-Corporation. Perhaps the reason why this option is canvassed in the Discussion Paper is that the 'flow-through' entity may not be encouraged to retain its profits. If profits are not retained, then anti-avoidance provisions such as the deemed dividend rules for private companies would no longer be required.

Importantly, the interaction between personal and business tax systems and how it influences the choices that small businesses make about business structures is also canvassed in the Discussion Paper. The incentives provided by both the dividend imputation and CGT systems for privately-held companies to retain earnings is seen in the Discussion Paper as an area where the tax system implicitly encourages the adoption of complex structures and makes the total compliance costs unnecessarily high. Further issues are identified in the context of trusts especially where there is a mismatch between the amounts on which a beneficiary is taxed and the amounts that they are entitled to under trust law.

In relation to the various concessions intended to benefit small businesses, such as the Goods and Services Tax (GST), CGT and industry specific concessions, the Discussion Paper seeks comments on the extent to which any benefits they provide outweigh the complexity and compliance burden they introduce. It goes on to pose a lower or zero tax rate for small businesses as an alternative option to the use of multiple concessions across the tax system. A lower rate to replace multiple specific concessions is said to potentially encourage small businesses to spend their resources expanding their business, rather than managing their tax affairs.

Indirect taxes

Goods and Services Tax

The Discussion Paper seeks community discussion and comments on the rate, base and administration of Australia's GST system and what changes should be made to the GST to improve the tax system.

However, the Government has tempered expectations about potential changes to the GST system by stating that potential changes will only be progressed through the Tax Reform White Paper process provided there is broad political consensus for change, including agreement by all State and Territory governments.

The Government has tempered expectations about changes to the GST by stating that changes will only be progressed if there is broad political consensus

With that caveat for change stated, the Discussion Paper makes the following observations about Australia's GST system:

- Australia's GST rate is one of the lowest among developed countries and is roughly half of that adopted by most OECD countries
- the exemptions to Australia's GST system means that GST was paid on only 47 per cent of all goods and services consumed in Australia in the 2012 financial year
- the main categories of exemption are certain fresh food, health, childcare and education services, and water, sewerage and drainage services. Certain financial services and residential rent are also exempt from GST but the inputs acquired to make those supplies are not recoverable through the GST input tax credit regime
- exemption for imported goods valued at less than $1,000 and the current inability to tax services (and intangibles) consumed in Australia but supplied from outside Australia is applying pressure to the GST base and affecting the competitiveness of some Australian businesses
- exemptions add to the complexity of the GST system, thereby increasing compliance costs for business and administration costs for government, and
- the proportion of consumer expenditure on exempt health, education, rent and financial services has been increasing since the introduction of the GST in July 2000.

The Discussion Paper also notes that the GST is an efficient tax which has a lower adverse impact on economic growth and living standards than other less efficient taxes.

The Government's caveat regarding the need for political consensus is disappointing but not surprising and previously flagged. However, the challenge for the Federal, State and Territory governments is to view any proposed changes to the GST system as part of the wider tax reform agenda.

Other Federal indirect taxes

The Discussion Paper also seeks comments on the mix, rate, base and administration of all other Federal indirect taxes and what changes (if any) should be made to these taxes to make a better tax system. The taxes in question include the following:

- fuel taxes, including the fuel tax credit regime
- alcohol taxes, including the current excise and wine equalisation tax regime
- tobacco taxes
- luxury car tax
- agricultural levies imposed on producers of certain agricultural products
- tariffs
- financial transaction taxes, including stamp duty on property and insurance taxes, and
- corrective taxes (usually advocated to address environmental or social concern).

While the Discussion Paper makes some general observations regarding these taxes (and certain user charges), it intentionally draws no conclusions. It is interesting that there is no specific mention of carbon-related taxes in spite of global moves in this direction.

Local and State/Territory taxes

The Discussion Paper seeks comments on the relative priorities and need for state and local tax reform including the factors that are required to balance equity, efficiency and transitional costs.

The Discussion Paper reports that two-thirds of current state tax revenue is generated from payroll tax, stamp duty on conveyances, motor vehicle registrations and insurance duties. One-third comes from taxes on land, gambling and other minor taxes.

The natural flow-on discussion of the relative priorities and opportunities for state tax reform is one about the inherent issues in raising revenue in a federation. There is considerable overlap between the Tax Reform White Paper and the Federation White Paper in this respect.

The Australian Government raises more revenue than it spends and the States spend more than they collect in revenue. This vertical fiscal imbalance, however, is higher in Australia than in most other federations. Despite this imbalance, the Discussion Paper notes that there is still the opportunity for the states to make better use of their existing tax bases.

Much of the discussion on whether the states and territories should only levy taxes on immobile bases (such as land) is centred on the argument that states in a federation will compete against each other to attract business and particular groups of people (e.g. through their different tax bases, rates, thresholds, exemptions and concessions) and this may lead to a ‘race to the bottom’. Others argue that competition and market forces lead to an optimal mix of taxes and services that meet our populations’ needs.

The Discussion Paper discusses a range of other State/Territory and local taxes. These are highlighted in the table below.

Table one: overview of State/Territory and local taxes

Payroll tax	• Levied on employers and based on certain components of employee remuneration, and representing the largest source of state revenue. • A relatively efficient tax because it generally increases as wages increase. However, in Australia it is less efficient and more complex than it could be because of tax-free thresholds and other exemptions. • Costs associated with an increase in payroll tax are likely to be borne by businesses in the short term, but in the long term, are likely to be passed onto employees through lower wages and / or to consumers through higher prices.
Stamp duty on conveyances	• Australia is relatively more reliant on stamp duty from conveyances of property than other countries. This source of revenue is highly volatile because it is largely dependent on property prices and the number of transactions. • Regarded as the most inefficient tax because it is applied selectively on certain activities and products and typically on the total transaction value, rather than being broad based and on the ‘value added’ component of the activity or product. It is therefore more prone to distortions in business decision making. • From a residential property perspective, the high transaction costs may be a significant barrier to moving, which then may become a barrier to labour mobility.

Property taxes	• The land tax base differs between the States and Territories. This results in significant foregone revenue and distortion of land use. • The Australian Capital Territory has begun to lead the way on property tax reform by replacing conveyance duties and insurance duties over a twenty year transitional reform period. • While municipal rates are regarded as the most efficient form of tax, there are concerns about consistency in how land values are determined and how rates are set between the different councils.
Other state taxes	• Other taxes relied upon for state revenue include insurance duties, motor vehicle registration duties, mineral royalties and gambling taxes.

Not-for-profit (NFP) tax

Tax concessions for NFP organisations are important from a tax policy perspective as they provide the Government with a means of supporting the role these organisations play in the community. The Discussion Paper recognises the contributions of NFP organisations, and highlights a range of tax exemptions at the State/Territory, local and Federal Government levels including exemptions from income tax, municipal rates, payroll tax, stamp duty and land tax, and various FBT and GST concessions. It is noted that while these concessions arguably help to improve societal outcomes and ensure the level of activity in the NFP sector is optimal, they are a significant source of forgone revenue and it is important to access their effectiveness.

Specific issues raised in the Discussion Paper include:

- FBT concessions for NFP organisations, in particular the current uncapped meal and entertainment, and entertainment facility leasing concessions which allow employees to utilise salary sacrificing arrangements to spend from pre-tax income, thereby reducing income tax payable
- whether there is a clear rationale for income tax exemptions for NFP organisations, and
- the complexity of achieving deductible gift recipient (DGR) status.

It is acknowledged that tax concessions often lead to distortions in the allocation of resources in the economy, and this is often the case with NFP tax concessions, particularly where the NFP organisation competes with for-profit providers. A significant amount of work was undertaken by the previous Government to ensure that tax concessions provided to NFP entities are targeted only at those activities which further their altruistic purposes. The current Government announced in December 2013 that it would not proceed with this measure at that point in time, but would explore simpler alternatives to address the risks to revenue. The Discussion Paper seeks to re-open this debate by posing a number of questions regarding NFP tax concessions.

Governance and administration

It is commendable that the Discussion Paper considers governance arrangements that an ideal tax system should have in place to support its design, ongoing maintenance and administration. The Discussion Paper provides an overview of the tax policy process in Australia and the roles that various institutions play in the development, implementation and review of Australia's tax system. Key issues arising from the current tax policy process are also highlighted, including lack of certainty for taxpayers and insufficient transparency in the development of tax policy. In this respect, the Discussion Paper raises potential options for tax policy reform to improve decision making by drawing from the tax policy development process in foreign jurisdictions (such as the United Kingdom's Office of Tax

Simplification and the New Zealand tax reform process), and to increase transparency by releasing more tax data and information around revenue costings.

It is acknowledged that Australia's tax system has become increasingly complex over time through the interaction of numerous factors involved in setting tax policy, drafting of tax legislation to reflect tax policy and administration of the tax law. The Discussion Paper highlights some of the consequences arising from the complexities in Australia's tax system, such as costs of compliance, unintended consequences and changed behaviours that may not accord with good policy outcomes. Although there is mention of the Government's approach to addressing some of these issues through its deregulation agenda and the actions taken by the Australian Taxation Office (ATO) to minimise complexity for taxpayers and improve the efficiency of tax system administration, it is clear that more work can be done.

Specific matters raised for consideration include:

- the development of a metric to measure complexity - a ‘tax complexity metric’ such as that used in the United Kingdom - that could be used to help identify areas of the law that are in most need of simplification and areas where reform could have the greatest impact
- system-wide approaches to reduce complexity in the tax system that has been created over the years by artificial boundaries and distinctions that do not reflect commercial or economic differences, concessions or rules for particular taxpayers or transactions, a ‘patch-work’ approach to amend the law to create particular outcomes, and complex drafting of law, and
- tax administration reforms to improve the experience of taxpayers when interacting with the tax system and to reduce compliance and administration costs through streamlined processes and increased use of technology. Examples of specific reforms are outlined, such as interfacing the ATO's systems with taxpayer's existing business processes, taking a whole-of-government approach to administration, and centralising the administration of some taxes.

Interactions with other reviews

Reform of the Federation

In June 2014, the Government kicked off the process for preparing a Federation White Paper. The Federation White Paper will, broadly, seek to clarify roles and responsibilities to ensure that, as far as possible, the States and Territories are sovereign in their own sphere. The White Paper is due for release by the end of 2015 and will be closely aligned with the Tax Reform White Paper.

The Terms of Reference for the Federation White Paper highlight issues such as:

- allocation of roles and responsibilities between different levels of government
- the issue of State governments raising insufficient revenues from their own sources to financial their spending responsibilities and
- the most appropriate approach for ensuring that horizontal fiscal equalisation does not result in individual jurisdictions being disadvantaged in terms of the quality of services they can deliver to their citizens, noting that this principle needs to be implemented in a way that avoids creating disincentives for them to improve their own revenue generation or to make the reforms necessary to improve the operation of their economies.

These areas have obvious linkages with the Tax Reform White Paper, including with regards to the effectiveness and efficiency of state taxes (some of which are considered to be the most inefficient taxes in Australia), and the GST. These issues are raised in Chapter 8 of the Discussion Paper.

The Second Issues Paper for the Federation White Paper - Roles and Responsibilities in Housing and Homelessness – which was released in December 2014 recognised that there are important links between the Federation White Paper and the Tax Reform White Paper with a number of tax settings at the Commonwealth and State and Territory level, such as negative gearing, CGT, superannuation, land tax and stamp duty, having an impact on the housing market. These issues are discussed in Chapters 4 and 8 of the Discussion Paper.

Other reviews

A number of other reviews currently underway or recently completed have interactions with the Tax Reform White Paper, including the Financial System Inquiry (as previously mentioned), the Productivity Commission inquiries, the Competition Policy Review and the White Papers on Agricultural Competitiveness and Northern Australia.

The Discussion Paper notes that separate review processes, which the Government has already announced, will be undertaken for the Taxation of Financial Arrangements rules and the tax consolidation rules. These issues will not be considered as part of the Tax Reform White Paper, however, it is noted that these are high priority issues for the Government.

What comes next?

With the release of the *Re:think* Discussion Paper on 30 March 2015, the Government has formally launched the Tax Reform White Paper process to create 'a better tax system that delivers taxes which are lower, simpler, fairer'. However this is just the start of a long process on the road to reform which will involve:

1. Consultation on the issues and questions raised in the Discussion Paper. The Government is committed to a national conversation on the matters raised, but also acknowledges that there may be other issues or views relevant to the tax system which also should be addressed. Comments can be made by formally submitting a response by 1 June 2015 to the Tax White Paper Task Force on the website www.bettertax.gov.au

2. An Options (Green) Paper is due in the second half of 2015. This will take into account the submissions received on the Discussion Paper and will outline a range of tax reform options which will also be subject to further consultation.

3. The Tax Reform White Paper will be released outlining the Government's tax reform proposals which it will take to the Federal Election due in late 2016.

PwC remains committed to joining the conversation on tax reform and strongly supports the development of a better tax system for Australia.

Refer to PwC's previous reports on tax reform:

- Why we need to talk about tax
- How do we fix a tax system?
- Analysis of the 2015 Intergenerational Report

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Tom Seymour
Brisbane
Managing Partner,
Tax & Legal
+61 (7) 3257 8623
tom.seymour@au.pwc.com

Paul Abbey
Melbourne
Partner, Corporate Tax
+61 (3) 8603 6733
paul.abbey@au.pwc.com

Jeremy Thorpe
Sydney
Partner, Economics
+61 (2) 8266 4611
jeremy.thorpe@au.pwc.com