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The Chair
Australia's Future Tax System Review Panel

By on-line submission through www.bettertax.gov.au website

Dear Sir,

Submission in response to Re:think Better Tax Discussion Paper

This submission responds to Questions 5, 6, 13, 14, 24 and 31 posed by the Re:think Discussion Paper.

Due to personal time constraints, my responses are short and in summary form and do not address many of the other questions, but I would be more than happy to expand further on any of these responses or comment on other questions if required.

Improving Fairness in the Tax System

I submit that the following are key areas where the current tax system can be improved:

1. A Better Family Taxation System.

The current tax system taxes individuals without regard to the dependents these individuals have to support. Currently, a person who has no dependents to support pays exactly the same amount of tax as a person who has to support several dependents (such as a spouse and children).

In recent years, even the small concessional tax offset for dependent spouses has also been progressively abolished.

Individuals should be given the option (if they wish) to be taxed as a family unit and be allowed to split their income with their non-income earning spouse. This would make our current tax system fairer and remove much of the incentive for families to restructure their affairs so as to be able to split income. The current rules often seem quite arbitrary. For example, the Tax Office allows tradesmen to split income with their wives through a partnership structure. However, the Tax Office has recently run a series of test cases to strike down contracting arrangements through which computer programmers tried to split income with their wives.

Other countries (such as France) tax families as a single taxing unit, which places the same tax burden on families regardless of how they structure their

income-earning activities. A similar reform is urgently required to make our income tax system fairer.

2. Restoring Fairness to Taxation of Capital Gains

Since 2006, non-residents are exempt from capital gains tax in relation to capital gains made from selling Australian assets (other than land or certain shareholdings). Australian residents do not have a similar exemption, and have to pay capital gains tax on all investment capital gains (such as capital gains made on shares).

The tax system should not favour non-residents over residents by providing non-residents with a tax exemption unavailable to residents. This exemption should be abolished so as to restore fairness to this part of the tax system. Otherwise, there will continue to be an incentive for Australian residents to move to a low-tax jurisdiction before investing in Australian assets.

3. Addressing Bracket Creep in Individual Tax Brackets

The current individual tax brackets seemed very generous when they were introduced, but will become less so over time as wages and prices increase. This will lead to families being worse off over time as lower- and average-income families are pushed onto higher tax brackets with higher tax rates.

There should be a process to increase these brackets over time in line with movements in Average Weekly Ordinary Time Earnings (“AWOTE”). AWOTE is preferable to the Consumer Price Index (“CPI”) since the CPI significantly understates real inflation as it does not take into account increases in rent or house prices (which have a significant impact on family disposable income).

To keep the tax brackets as clear “round” numbers, I would suggest that the brackets should be rounded up to the closest \$1,000.00 figure.

4. Fairer Individual Offsets

I believe it would improve the fairness of the tax system for a Non-income earning Spouse Offset to be introduced and the Medical Expense Offset to be reinstated.

As mentioned in point 1 above, a person supporting a non-income earning spouse simply does not have the same disposable income as a person not supporting any dependents. Non-income earning spouses are often active in the community in voluntary roles which benefit the community and add to social capital. The contribution of these volunteers needs to be recognized through the tax system.

With the Medical Expense Offset, the threshold set was very high (medical expenses of over \$2,000.00 excluding any expenses reimbursed by Medicare or private health insurance). Typically, this offset was only claimed by

families who had suffered serious health issues during the financial year which was largely not covered by Medicare. Examples I have come across over the years include serious major dental work and private hospital operations to treat an illness or injury producing serious pain but which was not immediately life-threatening.

Where a family has suffered from a serious medical illness to one of its members, I submit it is only fair that the tax system provide some help so that the full financial burden of this illness does not fall solely on the family in crisis. The medical expenses offset was also very modest (only 20% of net medical expenses over a high threshold). Reinstatement of this offset would restore some fairness to our tax system.

5. A Fair Company Tax Rate

The company tax rate should stay at 30%. The 30% rate still provides a significant discount from the top individual tax rate, but also allows for a reasonable collection of revenue by the Federal government.

A reduction in the company tax rate would only produce greater government revenue if it encourages a significant shift of companies based in other countries to shift their residency to Australia to take advantage of this lower tax rate.

However, given the much lower company tax rates offered by other countries, the company tax rate would have to be significantly reduced. Otherwise, a small reduction in the company tax rate will simply reduce the Federal Government's revenue from this source.

Even if Australia engaged in a "race to the bottom" to try to attract a large shift of companies to Australia, this tactic is unlikely to be successful. Other countries in this region with lower company tax rates (such as Malaysia and Singapore) also do not offer the same expensive health and social security benefits given by the Australian government. As their expense structure is lower, these countries would have greater scope to lower their company tax rates further if they felt threatened by competition from Australia.

Accordingly, any reduction in the company tax rate would simply shift more of the tax burden to ordinary Australians (who already bore 47.1% of the total tax burden in 2012-13 through individual income tax). This proportion is over double the percentage borne by company taxpayers (being 22.6%).

6. Fairer Taxation of Non-Resident Traders

Many small businesses throughout Australia have been harmed by the growth of the internet as a mechanism for consumers to buy goods and services.

The internet gives non-Australian trading businesses an automatic tax advantage over domestic businesses in most cases since the non-Australian business does not have to collect or remit GST on their sales to Australian

consumers. The non-Australian businesses also do not tend to pay Australian income tax on these sales.

This tax leakage has already been identified by the current government in relation to GST. Action needs to be urgently taken to subject these transactions to GST. In addition, action needs to be taken to bring these transactions into Australia's income tax net (subject, of course, to compliance with Australia's Double Taxation Agreements with other countries). It will be important to ensure that recently publicized cases of companies such as Google and Apple are addressed. It is unfair that companies such as these can earn significant profits from Australian consumers but pay relatively small amounts of Australian tax.

7. Transfer Pricing – Better Enforcement

There has been recent publicity in the press about how large companies like BHP Billiton and Rio Tinto are using transfer pricing to artificially reduce their Australian tax liabilities.

Rather than introducing new anti-avoidance provisions into the tax law (further increasing complexity and compliance costs for many other businesses), I submit that it would be better to simply ensure that the current laws are enforced.

If test cases are promptly run by the Tax Office in these cases, it should result in a greater and fairer tax contribution by these large companies (if the transfer pricing and general anti-avoidance provisions of Part IVA are found to be effective). Alternatively, if these cases are unsuccessful, it could show how these provisions are ineffective and how they should be reformed to ensure they are effective.

In this context, greater resources should be allocated to the Tax Office's audit and court enforcement teams to ensure that these issues can be promptly identified and for enforcement action to be taken.

Otherwise, the bulk of the tax burden will continue to be borne by ordinary individual Australian taxpayers, and not the larger taxpayers making significant real profits.

I hope my comments above are of assistance to the Panel in undertaking its review into Australia's future tax system.

Yours faithfully,

Suryan Chandrasegaran