Corporate Tax Association

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The Hon. Josh Frydenberg MP
Treasurer
House of Representatives
Parliament House
PO Box 6022
CANBERRA ACT 2600

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

Dear Treasurer,

2022-23 Pre-Budget Submission

The Corporate Tax Association (**CTA**) welcomes the opportunity to make a submission in relation to the upcoming 2022-23 Federal budget.

The CTA is the key representative body representing 145 major companies in Australia on corporate tax issues. A list of CTA members is attached as Appendix 1. Further information about the CTA can be found on our website at www.corptax.com.au.

The CTA's focus is on ensuring the tax laws (in particular those applying to large corporates), and their administration is as efficient and competitive as practicable. While this is our focus, we also fully recognise the constraints placed on public finances in the current environment. Though the Federal budget forecast position is relatively robust (and may have leeway for increasing budget deficits), significant uncertainties remain, notably around the impact on revenue and expenditure forecasts from the pandemic. With this in mind, the CTA is suggesting modest changes to the tax system in the upcoming budget that focus on:

- increasing labour productivity (thus increasing real wages for workers); and
- addressing specific issues giving rise to uncertainty and unnecessary compliance costs in the tax system.

Our recommendations will have minimal impact on forecast revenues in the medium term.

Summary of recommendations

1. An extension of the temporary full expensing measure by three years to 30 June 2026 or the introduction of some other investment incentive such as accelerated depreciation or an investment allowance.
2. Legislative clarity on the tax treatment of capitalised labour costs.
3. Changes to tax depreciation and FBT rules in relation to electric vehicles and hybrids.

4. Changes to the treatment of FBT on car parking benefits.

5. Changes to the tax consolidation rules as part of expected changes to capital gains tax (CGT) rollover rules.

6. Ensuring any potential introduction of the OECD/Inclusive Framework recommendations on Pillar Two do not create unintended consequences or unnecessary compliance.

Detail of recommendations

1. Extension of the temporary full expensing (TFE) measure or the introduction of some other form of investment incentive

While the existing TFE measure appears to have stimulated capital investment in 'off the shelf' assets, it does not provide an incentive to accelerate or commence new or improved long lead time national building projects. This is the case even when considering the proposed extension of the measure to new assets installed ready for use to 30 June 2023 in the 2021-22 Federal Budget, as many large investments have long lead times between the decision being made to invest and the asset being installed ready for use. For example, it is not uncommon for an LNG project to commence 10 years after inception.[1]

The current TFE rules also only apply to taxpayer groups with aggregated turnover below $5 billion and individual companies with Australian turnover less than $5 billion that have a history of capex spend of at least $100 million.

In our view, a truly effective TFE measure (in terms of genuinely stimulating large nation building medium to long term capital investment in Australia) should be available to all taxpayers and not be limited by turnover thresholds and/or requirements for past capital expenditure. However, if turnover thresholds are considered a necessary design feature of such rules, they should not be defined by complicated small business tax concepts such as "aggregated turnover" (which capture related party foreign turnover) but simply reference Australian based turnover.

If short term budget constraints caused by the pandemic are a concern, extending the availability of the TFE by an additional three years to expenditure incurred before 30 June 2026 should stimulate additional investment in some capital expenditure that may not be able to be undertaken in the 18 month window the current measure has to run (assuming the extension to 30 June 2023 is enacted[2]).

Full expensing for electric and hybrid vehicles

Alternatively, if extending the TFE to all asset classes is not regarded as an option, consideration should be given to rules (such as those that apply in the UK and Belgium) which provide for full expensing in the year incurred (or some other form

[1] See for example pwc-lng-progression-canada.pdf

[2] See Treasury Laws Amendment (Enhancing Superannuation Outcomes for Australians and Helping Australian Businesses Invest) Bill 2021

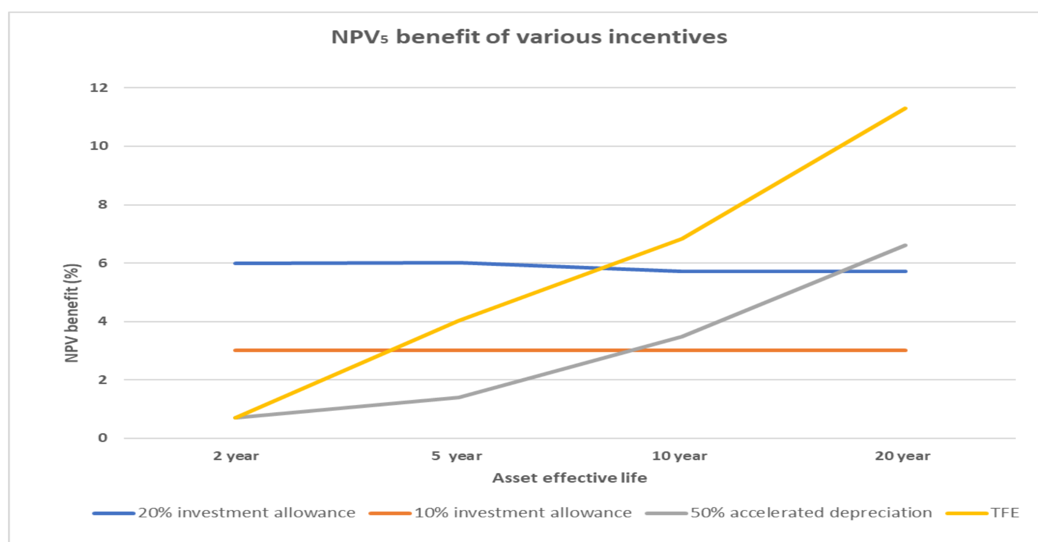
of accelerated depreciation) for new electric or hybrid vehicles as a permanent feature of our tax rules as a means to reduce carbon dioxide emissions[3]. Outside of electricity generation and stationary energy, transportation is the largest source of carbon dioxide emissions in Australia. Cars make up 45% of all transport emissions.[4] Consideration should also be given to changing the FBT treatment of electric and hybrid vehicles (see separate item below). Many European countries effectively exempt the provision of such vehicles to employees from income tax and/or provide concessional registration taxes[5].

Other incentive options

If budgetary constraints preclude the extension of the TFE, it is suggested some other form of investment allowance (**IA**) or accelerated depreciation should be considered as a means to encourage capital deepening.

For example, the following graph shows the net present value (**NPV**[5]) benefit of various investment incentives such as the TFE, a 50% acceleration of depreciation in year 1 and a 10% and 20% IA (as a permanent additional deduction) on assets with 2, 5, 10 and 20 year effective lives compared to current straight line depreciation.[6]

It shows that a 20% IA gives roughly a 6% NPV after tax benefit to an investment's tax depreciation profile regardless of an asset's effective life (with a 10% IA giving a 3% benefit). The graph also shows that a TFE style incentive is more advantageous in encouraging investment in longer life assets. For example, the after tax NPV benefit of TFE on a 20 year effective life asset is 11% (but only 4% for an asset with an effective life of 5 years).



[3] In the UK, EV and plug-in hybrid vehicles with CO2 emissions below 50 g/km are currently eligible for 100% write-down in the first year. To qualify, the vehicle must be brand new. EVs are also not subject to benefit in kind tax for company vehicles. The impact is similar to exempting in kind benefits from FBT. Company car benefit – the appropriate percentage (480: Appendix 2) - GOV.UK (www.gov.uk)

[4] See Australia's emissions projections 2021 | Department of Industry, Science, Energy and Resources chart_data.xlsx (live.com)

[5] See also EV_incentives_overview_2018_v2.pdf (acea.auto)

[6] The benefit is calculated as equal to present value of income tax that would be deferred over the effective life of the asset.

It is worth noting from a Federal budget financial perspective, while the NPV benefit to a taxpayer investing in longer life assets can be higher under a TFE regime than an IA regime (and lower on short lived assets), the latter is a permanent reduction in government revenue over the life of an asset, whereas a TFE regime or other accelerated depreciation regime are not.[7]

Depending on short, medium, and longer term budget constraints and policy views on whether more investment is needed in short or longer life assets, some form of incentive could and should be tailored to meet those policy objectives.

2. Treatment of labour costs related to the construction and creation of capital assets

We strongly suggest the Government consider providing legislative certainty on the circumstances in which labour costs (typically direct and indirect salary and wages and other related indirect costs such as payroll tax, maternity leave, and similar leave entitlements) will be deductible where such costs are directly or indirectly related to the construction and creation of capital assets.

Draft Taxation Ruling TR 2019/D6 Income Tax: application of paragraph 8-1(2)(a) of the Income Tax Assessment Act 1997 to labour costs related to the construction or creation of capital assets, which was issued in late 2019, is still in draft, consequently creating ongoing uncertainty around the correct treatment of these expenses.

The Australian Taxation Office (**ATO**) website notes "[w]e recognise that determining the capital/revenue distinction can, in some circumstances be difficult, and we will continue to work through the feedback received prior to finalising the Ruling. In the meantime, if you have any questions or have uncertainties in your position, you can ask us for private advice or other guidance that explains how the law applies to your particular circumstances."

We are aware of a number of significant ATO audits that have been subject to this compliance position. While audits on complex areas of tax law do and should occur, those that are being undertaken in this area have not only generated exorbitant compliance costs for the taxpayers concerned, but also remain unresolved. Such a position is wholly untenable, particularly given the treatment of capitalised labour costs is not a bespoke/industry specific issue applying to large capital projects. We are aware of cases where the compliance burden, coupled with the onus being on the taxpayer to prove the correct allocation of costs, have made it extremely difficult for the taxpayer to discharge the onus. Such uncertainty has come at an extremely high cost, with both taxpayers and the ATO spending many millions of dollars in advisory fees in sifting through emails, invoices and other source documentation.

A simple solution would be to introduce rules that extend the principles of full deductibility for salary and wage costs (and on-costs) regardless of whether an employee is working directly or indirectly on a capital project to equate with rules that apply to superannuation contributions under section 290-60 of the *Income Tax*

[7] In a simple example, a 20% investment allowance on a $100 asset results in $6 less tax revenue to the government over an asset's effective life compared to current depreciation rules, a TFE regime or an accelerated depreciation regime, without considering second round effects.

Assessment Act 1997. Deductions would still be denied for expenditure incurred in generating exempt income.

Like the extension of the TFE measure, the cost of such an amendment would be of a timing nature only and would better reflect the economics of capital projects by removing some of the economic distortion caused by requiring certain costs to be capitalised. It would also significantly reduce (if not remove) the cost of compliance for all taxpayers, including those that have not yet been subject to ATO scrutiny on the treatment of capitalised labour costs.

3. FBT and tax depreciation of electric vehicles and hybrids

It is submitted that the fringe benefits tax (**FBT**) laws need to be changed to better reflect the treatment of employers providing electric vehicles (**EVs**) to employees, including the installation of charging stations in employees' homes. Similar rules could also apply to both hybrid and plug-in hybrid vehicles (**hybrids**).

Historically, the taxable value of car fringe benefits has been determined by either the statutory formula method, which is based on the number of days in the FBT year the car was available for private use at a statutorily determined rate of 20%, or by the operating cost method, which is based on the operating costs of the car including ongoing costs such as fuel, insurance and maintenance costs adjusted for the amount relating to private use.

We understand that the 20% statutory percentage was chosen as an estimate of the value of the benefit provided of a non-electric/non hybrid vehicle which included the costs of fuel, registration and vehicle depreciation. In practice, many employers adopt the statutory formula for ease of compliance, given the operating cost method requires logbooks and the separate recording of the costs of the provision of a car.

It would appear applying a 20% statutory rate to an EV or hybrid would overstate the value of the benefit provided, seeing such vehicles do not have certain running costs and may be recharged at home by the employee at the employee's expense and require a separate charging module.

While employers could opt for the logbook method to reduce the FBT cost, tax rules that encourage more compliance in relation to the provision of EVs or hybrids only act as a further disincentive for their uptake, and create market distortions, which could impact other government policies on lowering carbon emissions.

In our view, as a minimum, the FBT laws need to be amended to create a different lower statutory rate for EVs and hybrids to better equate with the value of the benefit provided. Moreover, serious consideration should be given to exempting EVs and hybrids from FBT or alternatively reducing the statutory percentage to reflect an incentive to encourage the replacement of current vehicle fleets with EVs and/or hybrids.

We would also recommend that EVs and hybrids should also obtain permanent full expensing treatment beyond that which is effectively given in the TFE rules (see further above).

4. Clarification of the FBT treatment of certain car parking benefits

Corporate taxpayers are still waiting for clarification of the treatment of certain car parking benefits for FBT purposes from the Government.

This issue has been fraught with difficulty since the handing down of the decision in *FCT v Qantas Airways Ltd* [2014] FCAFC 168 which created a tension with the administration of the current 'car parking fringe benefits' rules in the *Fringe Benefits Tax Assessment Act 1986* (**FBT Act**). The tension arises between the original policy intent of the car parking fringe benefits rules, which was to impose fringe benefits tax on 'valuable car parking facilities - mainly in central business districts - that are provided by employers to their employees[8],' and the position in *Qantas* which has been interpreted to expand the concept of commercial parking station beyond commercially operated parking stations in a CBD as originally contemplated.

The ATO has finalised its position in Taxation Ruling TR 2021/2 Fringe Benefits Tax: car parking benefits which draws on the *Qantas* decision and expands the concept of 'commercial parking station[9]'. When applied, it potentially encompasses parking facilities provided by employers within a one kilometre radius of public and private hospitals, shopping centres and universities beyond parking stations located in a CBD as originally contemplated by the FBT Act.

It is submitted the Government should ensure the original policy intent of the rules is re-enforced and that FBT is imposed only on traditional standalone car parking facilities located in CBDs.

5. Reform of the consolidation rules following the Board of Taxation's review of CGT rollovers.

We support the review the Board of Taxation is undertaking of the CGT rollover rules, including demergers and scrip-for-scrip rollovers . While it is prudent to await the outcome of the review and the Board's recommendations, in our view there is merit in ensuring the review consider the interaction of other tax rules with the rollover provisions, particularly as they relate to the interaction with tax consolidation and the employee share scheme rules. In our view, the current rollover rules when interacting with other tax rules have unintended consequences, notably impacting the reset value of assets on the consolidation event. The current rules also appear to convert shares given to employees as part of an employee share scheme to be on capital account, whereas had the demerger not occurred, any gain made would be taxed as income to the employee on disposal. These unintended consequences need addressing.

[8] See the Second Reading Speech to the *Appropriation Bill (No. 1) 1992-93* (Cth) in the House of Representatives on 18 August 1992 at p60 for the 1992-93 Federal Budget by the then Treasurer, the Hon John Dawkins MP.

[9] With effect from 1 April 2022

6. **Ensure the introduction of the OECD/Inclusive Framework recommendations on Pillar Two do not create unintended consequences or unnecessary compliance.**

Prior to Christmas, the OECD/Inclusive Framework released its draft rules in relation to the introduction of the Global Base Erosion (**GloBE**) rules, which is aimed at introducing a 15% global minimum tax rate for certain large groups. While we note these rules are still in draft and consultation is continuing, some concerns have already been identified, most notably with transitional rules which appear to place a cap on deferred tax balances at the minimum rate of 15%. This seems contrary to the original policy intent of the GloBE rules, which was to ensure there is no top-up tax in circumstances where effective tax rates are higher than 15% in later years.

For example, an Australian group may have a subsidiary in New Zealand (**NZ**), but currently that subsidiary is a start-up with early losses. If the subsidiary later makes profits and pays NZ tax at 28% on such profits, it could end up paying top-up tax in Australia on losses that were in existence on transition. This unintended outcome is further exacerbated if any top-up tax paid in Australia is not frankable.

We strongly urge the government in any budget announcement it may make on the introduction of Pillars One and Two that it make it clear that any unintended consequences of the rules (including franking) will be addressed. We also urge the government to place appropriate emphasis on the need for compliance costs associated with the adherence to Pillar Two rules be kept to a minimum. This is particularly the case under the GloBE proposal for groups operating in Australia whose ultimate parent entity (**UPE**) is located in a country with a complying income inclusion rule. In such cases, any top-up tax would be payable in the UPE jurisdiction and not Australia. Requiring any detailed local Australian filing requirements in such a case would be needless.

* * *

Should you have any questions in relation to the above, please do not hesitate to contact Paul Suppree on 0408 185 050 or me on 0402 471 973.

Yours sincerely,

Michelle de Niese
Executive Director
Corporate Tax Association

CC: Ms Maryanne Mrakovcic, Deputy Secretary, Revenue Group, Treasury
Mr Bede Fraser, Assistant Secretary, Personal and Small Business Tax Branch, Individuals and Indirect Tax Division, Revenue Group, Treasury

Appendix 1

1	Acciona
2	Afterpay
3	AGL
4	Alcoa of Australia Limited
5	Allkem Limited
6	Alinta Servco Pty Ltd
7	Allianz Australia Limited
8	Amazon Web Services
9	AMP
10	Anglo American
11	ANZ Banking Corporation
12	API
13	Aristocrat Technology
14	Asahi Beverages
15	Atlassian
16	Aurizon Holdings Ltd
17	Australia Post
18	Australian Unity
19	BAE Systems Australia Ltd
20	Baker Hughes
21	Bank of Queensland
22	Barrick Gold
23	Bendigo & Adelaide Bank
24	BHP Billiton
25	BlueScope Steel
26	Boardriders Group
27	BOC Ltd
28	Boral
29	BP Australia
30	Brambles
31	British American Tobacco
32	Brookfield
33	Caltex Australia Limited
34	CBA
35	Chevron Australia Pty Ltd
36	CIMIC
37	Cleanaway
38	Coca-Cola Amatil
39	Coca-Cola South Pacific
40	Cochlear Limited
41	Coffey
42	Coles
43	Computershare
44	ConocoPhillips
45	CSL
46	CSR Limited
47	Downer EDI Limited
48	Domain

49	Dulux Group
50	EBOS Group Ltd
51	Elders Limited
52	Endeavour Group
53	Energy Australia
54	Energy Queensland
55	Engie
56	Esso Australia Pty Ltd
57	Fletcher Building Australia
58	Fortescue Metals
59	Frasers
60	GenesisCare
61	George Weston Foods
62	GFG Alliance
63	Glencore
64	Google
65	GrainCorp Limited
66	Hastings Deering
67	HRL Morrison & Co
68	HSBC Bank Australia
69	Iluka Resources Limited
70	I-MED Radiology Network Ltd
71	INPEX
72	Insurance Australia Group
73	Jacobs
74	James Hardie
75	Jemena
76	John Holland Group
77	Landmark (Nutrien)
78	Latitude Financial Services
79	Lend Lease Corporation
80	Linfox Pty Ltd
81	Link Group
82	Lion
83	Macquarie Bank Limited
84	Mazda Australia
85	Metal Manufactures
86	MIMI
87	MMG Ltd
88	National Australia Bank
89	Nestle Australia
90	Newcrest Mining Ltd
91	Newmont Asia Pacific
92	News Ltd
93	nib
94	Nine Entertainment
95	Nufarm
96	Optiver
97	Orica

98	Origin Energy
99	Orora Limited
100	Osaka Gas
101	Oz Minerals
102	Pacific Group of Companies
103	Pacific Hydro
104	Pacific National
105	Pepper Group Ltd
106	Powercor Australia Ltd
107	Qantas
108	QBE Insurance Group
109	REA Group
110	Rheinmetall
111	Rio Tinto
112	SA Power Networks
113	Santos Ltd
114	Scentre Limited
115	Schneider Electric
116	Seek Ltd
117	Seven Group
118	Shell
119	Sigma Pharmaceuticals
120	SingTel Optus
121	SkyCity
122	SMEC
123	Snowy Hydro Limited
124	South32
125	Stockland
126	Suncorp
127	Swisse Wellness
128	Tabcorp Holdings
129	Telstra
130	Thales Australia
131	The Arnotts Group
132	Toll Holdings Limited
133	Transurban Group
134	Treasury Wine Estates
135	Tyre and Auto
136	Vicinity Centres
137	Village Roadshow Limited
138	Virtual Gaming Worlds
139	Viva Energy
140	Wesfarmers Limited
141	Westpac Banking
142	WiseTech Global
143	Woodside Energy Ltd
144	Woolworths Group Limited
145	Zurich