

Taxpayers Australia
2010 – 2011 Pre-Budget
Submission



1. Executive Summary

Taxpayers Australia welcomes the opportunity to put forward its ideas and recommendations in relation to the 2010-11 Budget.

In line with our ideals, Taxpayers Australia is of the view that action is needed to deliver Australia a taxation system which is consistent with the following objectives:

- an equitable distribution of the taxation burden amongst taxpayers;
- simplicity, so that taxpayers can ascertain their correct liability with reasonable certainty;
- costs of compliance which do not place an unfair burden on any taxpayer; and
- sufficient flexibility to deal with economic, social, environmental and technological changes which can occur rapidly in modern society.

With these objectives in mind, for the 2010-11 financial year, the recommendations in this submission will focus on the following areas:

- Incentives for Australian individuals and households to maintain and increase their personal savings and investments;
- Incentives for personal exertion, small business and entrepreneurs;
- Incentives to protect the environment; and
- Improvements to the interpretation, compliance and administration of Australian tax law.

Our submission is mindful of the impacts of the global recession on revenues, the Government's strong commitment to fiscal discipline and the need to offset new spending with savings. However, where our proposals have a negative impact on Government revenues, we have attempted to re-distribute the costs. Nonetheless, we suggest that Treasury undertake the relevant costings to ensure the viability of our proposals.

We note that the proposals contained in this document, in its current form, have not been considered in light of any proposed recommendations contained in the forthcoming *Henry Review*.

We would be pleased to provide comment on any future draft legislation or policy documentation arising from the 2010-11 Budget.

2. Incentives for Australian savings and investment

2.1 *Tax concessions for personal savings*

Statistical data indicates that the level of Australian household saving has declined over the last 15-20 years and that the level of Australia's gross national saving rate is below the average of its OECD counterparts.

With the exception of savings for retirement by way of Superannuation Guarantee, there are presently no other tax incentives provided to individual taxpayers where interest income is being derived in cash or term deposits with financial institutions.

Given the imposition of income tax on interest income is at an individual's personal marginal tax rate and the lower rate of return on such investments relative to other investments, there is currently little incentive for such taxpayers to maintain a higher level of savings.

In addition, given that individual shareholders are entitled to franking credits under the simplified imputation system and possible access to the 50% CGT discount for investment by individuals in CGT assets (such as shares and real property), there is a distortion in the way such investments and savings are taxed.

Recommendation

To foster increased household savings in Australia and to provide parity with the taxation of other forms of savings and investments, we suggest that interest income from cash and term savings be concessionally taxed.

We envisage this to be achieved by exemption for interest income derived by individual taxpayers to the extent that their interest income does not exceed \$5,000 in each income year. If the interest derived exceeds this cap, then any excess would be taxed at the taxpayer's personal marginal tax rate.

2.2 *Retirement savings incentives for younger Australians*

Presently, under the superannuation guarantee contributions scheme, the compulsory amount required to be withheld by employers is 9% of the employee's earning base (ie. ordinary times earnings).

We draw attention to the latest research released by the Investment and Financial Services Association (IFSA) which showed that Australians are facing a large savings shortfall which would make it difficult to maintain a quality of life in retirement. According to the IFSA, the retirement savings gap has increased from \$452 billion in 2004 to \$695 billion. It was recommended that the current superannuation guarantee be raised to 12% of earnings.

In that research by the IFSA, it shows that younger Australians, are not making any additional contributions, outside of employer/ salary sacrifice contributions as noted by the following table:

Table. Assumed Contribution Rates - June 2008

| Age Group | Employer % | Member % |
|------------------|-------------------|-----------------|
| 25-29 | 9.00 | 0.00 |
| 30-34 | 10.16 | 0.74 |
| 35-39 | 11.51 | 1.60 |
| 40-44 | 13.05 | 2.58 |
| 45-49 | 14.79 | 3.68 |
| 50-54 | 16.53 | 4.79 |
| 55-59 | 18.26 | 5.89 |
| 60-64 | 20.00 | 7.00 |
| Average | 13.98 | 3.17 |

With an ageing population and the need to increase personal savings (as discussed above), we are of the view that improvements can be made to superannuation guarantee regime for younger Australians to begin saving for their retirement earlier.

Recommendation

With the exception of the superannuation co-contributions scheme, there is no other form of savings for Australians in lower income brackets. Therefore, in order to promote the benefits of saving for retirement for younger Australians, we suggest that superannuation guarantee required to be paid by employers be increased for younger Australians and phased out to the current 9% requirement using an aged-based scale.

For example, an aged based scale may be introduced such that additional contributions are required to be made for younger employees, say at 13-15% and phased-out to a lower percentage as the employee's age falls within a particular age bracket.

We believe that with the compounding effect on investment, that increased in savings by Australians earlier in their working life by way of compulsory superannuation contributions will assist in providing for their retirement.

We acknowledge that by increasing the superannuation guarantee contributions, that this may be an impost on employers and increase salary and wage demands (particularly, employees on minimum wage or subject to an award). It may also mean that employer may be less inclined to hire younger employees due to the additional costs.

In order to alleviate such an impost on employers, we suggest that if an aged-based superannuation guarantee contribution scheme be implemented, the following items also be introduced:

- To encourage employers to hire younger employees, an offset be provided by Government to supplement the additional superannuation liability. We believe that the proposed scheme better targets compulsory savings to younger employees, as opposed to targeting employees on lower incomes.
- In addition, to assist in funding the additional costs, to the extent that younger employees have a student loan under the HELP scheme, we suggest that scales for the repayment for HELP be adjusted. As a result, this would likely prolong the payment of the HELP loan, with the funds being reallocated to superannuation savings.

We consider this proposal to be innovative in approach and application, and that such an approach will assist young Australians to save at an earlier stage of their working life and to provide additional funds for retirement and lesser burden on the transfer system (by way of pensions).

2.3 Reduction of capital gains tax on long term asset holdings

At present, the CGT discount applies to capital gains derived by individuals, trusts and superannuation funds, where broadly, the assets are held in excess of 12 months.

According to the 2008 Tax Expenditures Statement, the cost of providing the capital gains tax discount to the Government for the 2010-11 year is \$7.670 billion

In addition, there are exemptions from capital gains tax on the disposal of certain CGT assets (such as the family home under the main residence exemption).

Recommendation

Taxpayers Australia is of the view that to encourage longer term investment by introducing a phased system of discounting capital gains such to the following:

| Ownership Period | Proportion of Gain Taxed |
|--------------------|--------------------------|
| Up to 1 year | 100% |
| 1 – 5 years | 50% |
| 5 –10 years | 25% |
| More than 10 years | 0% |

In adopting this approach, we believe that the existing flat CGT discount should be scrapped. Further, we note that the tax burden under this approach will be re-allocated to taxpayers who hold their assets for short term gain and rewards long term investment.

Consideration would also need to be given to the types of taxpayers with which a phased system of reduced capital gains would apply to. In this instance, we suggest that the status quo be maintained and that the phased system to apply to individual taxpayers, trusts and superannuation funds and not companies.

2.4 Superannuation – eliminate taxation on contributions

In the 2009-10 Budget, the concessional contributions cap was reduced from \$50,000 to \$25,000. This relates to contributions from superannuation guarantee and salary sacrifice arrangements.

Any “concessional” contributions in excess of this cap is subject to tax at 46.5% (ie. 15% contributions tax plus an additional 31.5% taxed in the fund).

From 2009-10, the non-concessional cap (ie. Personal contributions from after tax dollars) is \$150,000.

According to the *Tax Expenditures Statement 2008*, it is estimated that the cost of concessional taxation of employer contributions would be \$10.9 billion for the 2009-10 year.

In its present form, it may be argued that Australia’s superannuation system favours higher income earners compared with those on lower incomes. In other words, there is inequity in the taxation of superannuation contributions depending on an individual taxpayer’s income.

For example, a taxpayer at the top marginal tax rate of 45% who decides to salary sacrifice their income will receive a tax discount of 30 cents in the dollar, as their superannuation contribution will be only taxed at 15%. A taxpayer who pays no income tax on their income would be subject to 15% tax on their contribution.

Therefore, at present, the taxing of contributions does not distinguish between those on high or lower incomes. There is not sufficient incentive for lower income taxpayers, with the exception of the co-contributions scheme, to boost their retirement savings.

Recommendation

As noted above by the IFSA, given the increased gap in retirement savings, there is an increased need to boost retirement savings, including how contributions are taxed.

On that basis, Taxpayers Australia suggest that to provide incentive low income earners who derive income up to a certain income threshold that an offset be provided such that low income taxpayers pay no tax on contributions and that those above that threshold contributions continue to be taxed at 15%.

Over a period of time and as a long term objective, we would envisage that tax on contributions be eliminated completely. This would ensure that taxpayers have sufficient savings for retirement, provide equity to those on various income levels and put less pressure on the transfer system by way of pensions.

2.5 Retention of “classic” imputation system

At present, the current imputation system allows a refund of franking credits to the extent that the available imputation credits cannot be offset against any income tax payable by individual taxpayers.

This generally occurs in circumstances where the taxpayer is in a low income bracket, such as retiree, who would benefit from the ability to benefit from cash refund of any excess franking credits.

Recommendation

Taxpayers Australia recommends that the “classical” imputation system be retained so that credits arising from taxes paid by companies, particularly for low income individuals and for retirement savings purposes.

3. Incentives for personal exertion, entrepreneurs and small business

3.1 *Alignment of personal marginal tax rates with corporate tax rate*

In our pre-Budget submission for 2009-10, we had noted the global trend towards reduced corporate tax rates. Based on the KPMG International survey of global company taxes concluded that the average corporate rate is 25.9%.

Recommendation

Unless such a recommendation is made in the upcoming *Henry Review*, we suggest that consideration be given to the reduction of the company tax rate from 30% to 25% to not put Australian companies at a disadvantage.

In addition, for the 2009-10 income year, an individual taxpayer who has a taxable income of \$155,000 would be paying an effective tax rate (excluding Medicare levy) of 30%. According to comments in relation to the 2006-07 Budget, the tax cuts provided at that time, resulted in 80% of individual taxpayers paying no more than 30 cents in the dollar in tax.

If there was a reduction in the corporate tax rate as intended to 25%, then taxpayers who have a taxable income in excess of \$100,000 (excluding Medicare levy) will be paying an effective tax in excess of 25% based 2009-10 rates.

In addition, to also prevent bracket creep from arising, we also suggest that consideration be given to the indexation of the personal tax thresholds so that individual taxpayers are not disadvantaged due to the increase in the cost of living.

Therefore, in the event that such a recommendation is initiated, consideration should be given to the reduction of personal income tax rates such that a majority of individual taxpayers will be paying an effective tax rate of no more than 25 cents in the dollar.

In addition, the closer alignment of the personal tax rates for a majority of individual taxpayers with any reduction to the corporate tax rate will also assist in taxpayer's devising schemes that uses a company as a preferred tax structure, or which defers that taxing point from the ultimate beneficiaries and the subject of Part IVA of the *Income Tax Assessment Act 1936*.

3.2 Improvements to the entrepreneur's tax offset

As it currently stands, the entrepreneur's tax offset, applicable after 1 July 2005, provides an offset of up to 25% of the income tax liability attributable to a taxpayer Simplified Tax System (STS) business income.

In order to be eligible for the offset, the conditions which need to be satisfied include:

- the taxpayer's STS group turnover for the year is less than \$75,000; and
- the taxpayer has a "net STS income" for the year.

A full offset is available where the turnover is less than \$50,000 and the offset is phased out as the turnover approaches the cap.

On this basis, as it stands, if an entrepreneur conducts business as a sole proprietor and has STS income for the year of \$50,000 and deductible expenses of \$20,000, the applicable tax offset available on a taxable income of \$30,000 would be \$2,250 (a tax liability of \$6,750) for the year ended 30 June 2010. This benefit is lost and is partially phased out once it exceeds \$50,000.

In addition, the Government intends to further restrict the eligibility of the offset by having an income test which reduces the extent of the ETO for individuals from \$75,000 and families from \$120,000 based on "non-ETO income" (ie. the income test). This proposal has been introduced as an Exposure Draft in Tax Laws Amendment (2010 Measures No.1) Bill 2010.

Taxpayers Australia has made a submission with respect to the application of those proposed provisions.

Recommendation

Taxpayers Australia is of the view that as currently legislated and with the proposed introduction of an income test, the ETO does not provide adequate incentive for individual taxpayers to undertake their own business ventures.

In our view, a salary and wage earner would be unlikely to give up their gross salary (excluding superannuation guarantee) of \$50,000 to undertake their own business venture (coupled with additional outlay and expenses in that business'infancy).

Arguably, entrepreneurs should be better rewarded for undertaking the additional risk in establishing a business (such as uncertain income stream, financing and increased administrative burden).

Therefore, to encourage and better reward entrepreneurship in the Australian community, we recommend the following improvements to the entrepreneur's tax offset:

- the turnover threshold for eligibility to the entrepreneur's tax offset be increased from \$50,000 to \$75,000, with phasing out as \$100,000.
- the rebate be increased from 25% to 30%. This increase in the rebate can be introduced at an appropriate time by Government and in our view, provides a better reward for the additional risks borne by entrepreneurs;
- to the extent that the taxpayer makes PAYG instalments, the rebate be factored in as part of quarterly instalment activity statements to assist with improving the businesses cash flow over the course of the year (as opposed to receiving the rebate at the end of the year when the tax return is lodged); and
- the offset not be available after the third year in which the taxpayer is in business (unless there are exceptional circumstances which may warrant an extension). We consider that at this point, the business is not considered to be an "entrepreneurial" business. The ETO as it current stands does not impose any time limit.

If the above turnover threshold is adopted, in doing so, we recommend that the income test as contained in the Exposure Draft be omitted.

This is on the basis that increased income thresholds implicitly acts as an income test by aligning the ETO with what we consider to be the appropriate recipients. Albeit, we concede that the increased thresholds does not reduce the ETO as the income tests do.

An example of how our proposed changes will impact a sole proprietor with a business turnover of \$75,000, net income of \$60,000 and no other external income is as follows:

Example.

| | Salary and wage earner | Current 25% ETO (including income test¹) | Proposed 30% Taxpayers Australia ETO |
|--|-------------------------------|--|---|
| Taxable income | \$60,000 | \$60,000 | \$60,000 |
| Basic income tax liability ² (excluding Medicare levy) | \$11,850 | \$11,850 | \$11,850 |
| Small business percentage | N/A | 100% | 100% |
| ETO = ETO % x basic tax liability x small business percentage x phase-out fraction ³ | - | \$1,778 | \$3,555 |
| Reduction due to income test: | N/A | N/A ⁴ | N/A |
| ETO: | N/A | \$1,778 | \$3,555 |
| Total tax payable after offset: | \$11,850 | \$10,072 | \$8,295 |

Based on the foregoing, under the proposed ETO regime, there is an additional benefit to the individual taxpayer of \$1,777 (ie. \$3,555 less \$1,778) (effectively double in this instance).

Further, to compensate for the risk of being in business, under the proposed ETO, an individual is better off by \$3,555 over a salary and wage earner.

We consider that proposed increase to the turnover threshold and rate of the rebate from 25% to 30% provides a better reward for entrepreneurs and better compensates for the additional risks undertaken.

It will also provide additional, on-going cash flow in the business' infancy and the three year time limit will allow the ETO to not be abused and is better aligned with its intended purpose and provide Government with cost savings.

¹ Application of income test consistent with proposed provisions contained in Tax Laws Amendment (2010 Measures No.1) Bill 2010.

² Based on 2009-10 personal and company tax rates

³ In this case, phase out fraction is 60% (being \$75k - \$60k/\$25k)for current ETO and 100% for proposed ETO

⁴ Does not apply as income below \$70,000

3.3 Carry-back of tax losses for small business

As a result of the global financial crisis, it would be expected that for the 2009-10 year, a considerable portion of businesses will be in carry forward tax loss positions.

Businesses which are in such positions would benefit greatly for additional cash flow to assist with their day to day operations and available when they most need it (compared with the recoupment of losses where there is future taxable profits available).

Recommendation

Taxpayers Australia recommends that to assist company taxpayers as they move out of the global economic crisis, companies would greatly benefit from the ability to recoup taxes which have been paid in the past to assist in the day to day operations of their business. That is, we recommend that a carry back regime be introduced by the Government.

Recognising that most business are subject to cyclical factors, often including issues beyond their control, there is generally a logic to the availability of a loss carry back regime. We view this as being greatly beneficial to all businesses, in particularly, small businesses in the community.

In addition to the application of continuity of ownership test and same business test as they currently stand for the “carry back” period, specific rules would have to be developed for a carry-back loss regime, including the number of years of “carry back”.

We note that there is ample international precedent as a significant number of OECD countries have adopted this approach, such as the United States and United Kingdom. For example, in the United Kingdom, the carry back period is 3 years.

Whilst we appreciate that providing such a regime may be costly to the Government if provided to all company and business taxpayers, at the very least, we would consider that such a regime be provided to taxpayers who fall within the meaning of “small business taxpayer” for income tax purposes.

4. Incentives to protect the environment

4.1 Revised statutory formula method

According to the ATO Annual Report 2008-09, the total fringe benefit tax collection is \$3.4 billion. Just over half of that total collection relates to motor vehicle and expense payment fringe benefit.

Currently, there are two methods of costing the benefit in order to determine the extent of the FBT liability. These two methods are the statutory formula method and the operating cost method.

In practice, the statutory formula method is the most commonly adopted approach in determining the taxable value and therefore, the FBT liability with respect to the provision of car fringe benefits.

More specifically, the original purpose of the statutory formula method for valuing car fringe benefits was to apply tax to the private use of the vehicle, not its use for work purposes, and the distance travelled was used as proxy for the proportion of business travel. That is, the more distanced travelled, the less FBT which is paid. This is determined by the “statutory fraction” contained in the formula as follows:

0 - 14,999: 26%

15,000 - 24,999: 20%

25,000 - 40,000: 11%

40,001 +: 7%

In most instances, relative to the operating cost method, this method concessionally taxes the provision of motor vehicle benefits under the FBT regime.

Recommendation

Taxpayers Australia is of the view that the statutory formula method does not necessarily achieve its intended outcomes of taxing the private use component of a car fringe benefit.

This is on the premise that increased use of the vehicle does not necessarily equate to additional business use. Further, the increased use of the vehicle, irrespective of whether the vehicle is used for private or work purposes, increases the level of carbon emissions.

Taking into account the above reasons and in light of recent debate in relation to the Governments’s Emissions Trading Scheme, Taxpayers Australia recommends that the FBT concession available under the statutory formula method be revised such that FBT be reduced where the carbon emissions released from the use of a car are reduced.

In our view, there are three possible approaches to revising the statutory fraction to achieve this outcome. These methods include a statutory fraction based on:

- fuel consumption figures;
- carbon emission figures;
- a combination of distance travelled and carbon emissions (ie. tonnes of carbon dioxide released by the vehicle per FBT year)

A discussion with respect to each method is outlined below.

Fuel consumption figures

This may be achieved by allocating a reasonable statutory fraction to a motor vehicle's prescribed fuel efficiency⁵:

0 – 7 litres/100km: 7%

7.01 – 10.49 litres/100km⁶: 11%

10.50– 13.49 litres/100km: 20%

13.5 litres and above: 26%

Presently, under the rules with respect to the luxury car tax, an exemption from LCT is available where the car is considered to be a fuel efficient car is one which has a fuel consumption of less than 7 litres per 100 km. This appears to be the benchmark for an above average fuel efficient vehicle.

As technology improves in local and overseas vehicles produced, the statutory fraction may be adjusted to accommodate such improvements.

The negatives associated with this method is that it may not factor in the driving conditions in which the motor vehicle used (ie. city combined with urban driving) and therefore, rewards employers for the choice of vehicle adopted as opposed to its actual usage (ie. distance travelled)

⁵ The prescribed fuel efficiency based on a litre/100km measurement can be sought from the combined cycle under the ADR81/02 *Fuel Consumption Labelling for Light Vehicles*. For new vehicles, this information is readily available on www.greenvehicleguide.gov.au.

⁶ Holden Commodore MY10 (auto transmission) and Ford Falcon (auto transmission) MY10 would fit within this category.

Carbon emissions figure

As opposed to using fuel consumption figures in determining the extent of the FBT liability, an alternative may be to use is the amount of CO₂ emitted by the vehicle.

If this is the case, we would envisage a statutory fraction would be as follows⁷:

| | |
|---|-----|
| 0 – 100g of CO ₂ /km ⁸ : | 7% |
| 101– 180g of CO ₂ /km ⁹ : | 11% |
| 181 – 250g of CO ₂ /km ¹⁰ : | 20% |
| 251g of CO ₂ /km and above: | 26% |

Given that fuel consumption does not necessarily equate to the amount of carbon emissions, this method provides a more precise method as to the environmental impact caused by the vehicle as opposed to its consumption of fossil fuels. For example, cars which use LPG have higher consumption, but reduced carbon dioxide emissions relative to their petrol counterparts.

Again, the negatives associated with this method is that it rewards employers for the choice of vehicle but not the distance travelled and its real world use, which may alter over the life of the vehicle.

Combination of distance and carbon emissions

Another alternative would be to adopt a statutory fraction which combines the use of the vehicle and the kilometres travelled.

This may be achieved by multiplying the number of kilometres travelled per year with the CO₂ per kilometre released by the vehicle, which will give rise to the volume of CO₂ released per annum.

⁷ The CO₂ emission figures listed is based on a g/km of CO₂ (combined) emitted. For new vehicles, this information is readily available on www.greenvehicleguide.gov.au.

⁸ Toyota Prius (CVT transmission) will fit within this category with CO₂ emissions of 89g/km. This is the most environmentally car current available on the Australian market.

⁹ Toyota Corolla 1.8 Litre Ascent (manual transmission) will fit within this category with CO₂ emission of 171g/km.

¹⁰ Holden Commodore 3.0 litre SIDI (auto transmission) will fit within this category with CO₂ emissions of 221g/km.

As a result, sample statutory fractions may be as follows:

- 0 – 2.0 tonnes of Co2 per FBT year¹¹: 7%
- 2.01 – 4.5 tonnes of Co2 per FBT year: 11%
- 4.51 – 6.0 tonne of Co2 per FBT year: 20%
- 6.01+ tonnes of Co2 per FBT year: 26%

This method promotes the use of fuel efficient cars if there is significant use of that vehicle during the FBT year. For example, if the car is used by a salesperson which would have significant distance travelled, it would be in the employer's interest to provide a fuel efficient vehicle.

Again the concession rewards employer's for choice of vehicle as opposed to the level of business use.

Taxpayers Australia acknowledges that these approaches may be viewed as being radical. In our view, the third option would be the more fair and equitable option in taking into account the use and the carbon footprint of that vehicle.

While it may be argued that the methodology in determining the FBT liability has minor relevance to the private use of that vehicle, in the interest of reducing carbon emissions and for the Government to demonstrate its climate change credentials, we believe that an exception should be made in this instance.

Also, we believe that in adopting this approach, employers would receive a reduction to their FBT by having a low-emission car fleet. Equally, this would be of benefit to the environment. As a result, we envisage that this should have a neutral impact on Government revenue.

Nonetheless, to adopt the approaches identified above, we would recommend that Treasury undertake the relevant costings and forecasts to determine its viability (particularly, its impact on current and future government FBT revenues and fairness of individuals in receipt of the benefit).

In addition, we acknowledge that the local car industry, namely Holden, Toyota and Ford will have observations with the potential impact of such an approach on local car manufacturing. However, we believe that this also provides incentive the local car industry to improve the emissions of Australian built vehicles.

¹¹ A Toyota Corolla which travels 10,000 km a year (approx 1.6 tonnes of CO2 per year), or a Toyota Prius which travels 20,000 km per year (approx 1.8 million tonnes of Co2 per year) would be taxed at the lowest statutory fraction.

5. Improvements to the interpretation, compliance and administration of Australian tax law

5.1 Revision to the minor benefits rule

Under the minor benefits rule contained in section 58P in the *Fringe Benefits Tax Assessment Act 1986*, a benefit provided would be considered to be exempt from FBT to the extent that:

- It is less than \$300 in value; and
- It is considered that it is unreasonable to treat the benefit as a fringe benefit.

There are five criteria which need to be considered in determining whether it would be unreasonable to treat the minor benefit as a fringe benefit. One of these criteria how infrequent and irregular the benefit is provided.

On this basis, it is generally accepted, an employee may receive a number of benefits which individually is less than \$300 in value, but collectively the value exceeds this cap, yet all benefits provided may be considered to be “minor benefits”.

We also note that the Commissioner of Taxation has provided his views on the application of the minor benefits rule via *Taxation Ruling 2007/12: Fringe Benefits Tax: Minor Benefits*. In this instance, we note that the interpretation of “associated benefits” is difficult to follow and interpret.

Further, we note that meaning of a minor benefit has also been included as an exception to the proposed rules in relation to the use of assets by shareholders in a private company under the non-commercial loan rules (as contained in *Tax Laws Amendment (2010 Measures No.1) Bill 2010*).

Notwithstanding the guidance provided in the Ruling, as a general observation, in practice, there is uncertainty by employers in determining whether a minor benefit would satisfy all the relevant criteria. In particular, as noted above, where there are multiple benefits provided which are associated.

Recommendation

Taxpayers Australia recommends that the minor benefit be amended such that the value of each benefit remains less than \$300 in value but the total minor benefits provided does not exceed \$1,000 per employee per FBT year.

In having a fixed monetary cap, we suggest that the requirements in whether it is “unreasonable to treat the benefit as a fringe benefit” be removed.

To the extent that the “otherwise deductible” rule or another provision applies in the provision of such a benefit, this should not be included in the \$1,000 cap. In other words, this should be a provision of last resort.

We note under New Zealand FBT law, there is a \$300 exemption per employee per quarter from paying FBT if the employer provided free, subsidised or discounted goods and services. In addition, the exemption is limited to \$22,500 per annum per employer.

We would envisage cost savings to Government in terms of administration and compliance for employers, if the minor benefit rule was revised to a monetary cap. Most importantly, as with the New Zealand “minor benefit” rule, there would be no uncertainty for taxpayers with respect to the intended application of the minor benefit rule.

We conceded that in adopting this approach, consideration will also need to be given to other areas of FBT law, such the \$500 reduction available for the provision of in-house fringe benefits and exemptions or reductions available for other benefits.

In addition, to the extent that the cap is set at \$1,000 per annum and no other fringe benefits are provided to that employee, there should not be any implications with respect to disclosure for reportable fringe benefit tax purposes, which only applies where the taxable value of the total benefits provided exceeds \$2,000.

5.2 Rewrite of the FBT legislation

Taxpayers Australia welcomes the current re-write of certain provisions in the Income Tax Assessment Act 1936 to the Income Tax Assessment Act 1997. This has recently been demonstrated by the rewrite of certain provisions as contained in the *Tax Laws Amendment (Transfer of Provisions) Bill 2009*.

The Fringe Benefits Tax Act 1986 as is presently stands is difficult to follow and interpret. In particular, definitions, the order of benefits provided and available exemptions are not necessarily clearly identifiable.

Recommendation

Given that the provisions are now over 23 years old, there is a need to modernise the provisions. Should it be intended that the fringe benefits tax be retained, Taxpayers Australia recommends that to provide clarity to users that a re-write be performed using modern drafting techniques to ensure ease of use and interpretation.

On that basis, a suggested format for a re-write may be as follows:

- a main operative provision be inserted to outline whether a fringe benefit has been provided to an employee (such as section 8-1 of the Income Tax Assessment Act 1997 or section 9-5 in the GST Act);
- a subdivision detailing the calculation of taxable value and an employer’s FBT liability;
- a summary of the types of benefits be outlined similar to CGT events listed at section 104-5 ITAA97;
- a subdivision detailing the general exemptions, such as the minor benefit rule and otherwise deductible rule;

A re-write will also provide Government with the opportunity to simplify the application of certain provisions (for example, the minor benefit rule as mentioned above) or to remove obsolete rules.

We note that the re-write, using modern drafting techniques, can significantly reduce the administration costs for employers and for the Australian Taxation Office if the interpretation is clear and unambiguous.

In addition, we also suggest that where relevant, that the imposition of be FBT take into account the environmental impact of providing certain benefits (eg. cars as noted above).

5.3 Improvements to tax administration arising from amendments to section 23AG

Following the Budget for 2009-10, it was announced that section 23AG of the *Income Tax Assessment Act 1936* be amended in respect of foreign employment income derived by Australian resident who are engaged in foreign service for a continuous period of 91 days or more.

More specifically, the law, as enacted limits the application of section 23AG such that the exemption from income tax only applies to certain types of employment.

On this basis, for the majority of Australian residents who are deriving foreign employment income, there is an additional administration requirement for the employers of such employees.

In the main, these centre on the requirement for employers to withhold income taxes under PAYG withholding system and possible fringe benefits tax liabilities from the provision of non-cash benefits to these employees. This has placed additional administrative burden on employers.

Whilst Taxpayers Australia does not necessarily object to the amendments to section 23AG, we do have reservations with respect to the additional administrative burden and the uncertainties which have arisen for both foreign based employees and their employers.

As a result of these amendments, we note the following anomalies which we believe should be resolved as part of the forthcoming Budget:

(i) Double taxation of benefits

FBT did not previously apply to benefits provide where the employee derived exempt income. However, due to the amendments, non-cash benefits to Australian resident, foreign based employees would be subject to fringe benefits tax.

In addition, in most foreign jurisdictions, the receipt of fringe benefits would be taxed in the hands of the employee as employment income.

The current FBT provisions do not provide any exemption where foreign tax has been paid by the employee on benefits received. Presently, only Double Tax Agreements in the United Kingdom and New Zealand prevents double taxation in relation to fringe benefits. Other jurisdictions do not provide such relief.

Recommendation

Taxpayers Australia recommends that to the extent that foreign tax is payable on employment income on the receipt of benefits and the employee is entitled to a foreign tax offset, we recommend that such benefits be exempted from fringe benefits tax.

However, where there is no tax levied on the benefit in the foreign jurisdiction, then there is scope for FBT to continue to apply in Australia.

Similarly, where a taxation treaty between a foreign jurisdiction and Australia prevents double taxation in relation to fringe benefits, then fringe benefits tax regime should continue to apply.

(ii) PAYG withholding

To the extent that income is no longer exempt under section 23AG, there is now a requirement to withhold payments from salary and wage income.

We note that a legislative Instrument was previously released, which allows for a PAYG withholding class variation to be made by the employer, whereby, in broad terms, the employer would be withholding less PAYG on behalf of their employees to the extent that foreign income taxes is already being paid by the employee in the foreign jurisdiction.

In practice, the requirement to withholding PAYG payments places a significant burden on employers to withhold taxes not only in the foreign country in which the services are being performed but also in Australia.

Recommendation

We suggest that there should not be any PAYG withholding where an Australian based, foreign based employee is in a jurisdiction which has comparable taxes as that of Australia.

Having regard to the current Controlled Foreign Company rules, we consider that employees based in “broad exemption listed country” and “limited exemption listed companies” should not any PAYG withholding by the employer.

We believe that this will assist to reduce the administrative burden placed on employers.

To the extent that individuals are comparably tax, the availability of a foreign tax offset would likely mean that there would be a refund of PAYG withholding payments made by the employer to the employee when they lodge their income tax return.

PAYG withholding would be required to be undertaken where work is undertaken in an “unlisted country” or where there is no tax treaty between Australia and that country.

(iii) Employer located in foreign jurisdiction

Currently, there is no guidance on whether foreign based employers are required to register for PAYG withholding purposes.

In addition, there may be jurisdictional difficulties in enforcing the requirement for an employer in a foreign location to withhold PAYG on behalf of Australian resident employees.

Recommendation

To reduce the administrative burden which may potentially be placed on foreign-based employers, Taxpayers Australia recommends that the tax liability of an Australian resident, foreign based employee be paid by the employer at year end upon the employee lodging their income tax return at year end.

Therefore, the impetus would be on the employer to put aside funds at year end to pay for the employee's tax liability.

Where the employer has a permanent establishment in Australia, then this requirement will not apply and the employer will need to ensure that the correct PAYG instalments are being remitted.

Amongst other commercial drivers, we do not believe that our recommendation alone will act as a disincentive for foreign resident companies to set-up a permanent establishment in Australia.

In addition, in simplifying the administration for foreign based employers, it would not provide a disincentive to such foreign based employers to hire Australian resident taxpayers compared with employees from other countries.

(iv) Fly in, Fly out arrangements

Pursuant to section 47(7) FBTA86, an employer would be exempt from fringe benefits tax where travel is provided to employees under a fly-in, fly-out arrangement where the employees work on an oil rig, or other installation, at sea or at a location in a State or Territory that is not in, or adjacent to an eligible urban area.

As a result of the amendment to section 23AG, to the extent that such benefits are provided to Australian resident employees who work on a foreign based oil rig; or other installation at sea, an employer would likely be subject to FBT as an exemption under section 47(7) would not be available.

Recommendation

Taxpayers Australia recommends that section 47(7) be extended to apply to the provision of benefits to Australian resident employees under fly in, fly out arrangements.

We consider that employers who employ Australian resident employees working under such circumstances in a foreign jurisdiction should not be discriminated against compared with employees working in Australia.

This will maximise the attractiveness of Australian expertise in foreign jurisdictions, particularly in areas of expertise concerning natural resources.

Concluding comments

As noted, the intentions of our proposals is to encourage Australians to undertake savings and long term investment, provide incentive to entrepreneurs and small business, protect the environment and to simplify the administration of the Tax Act.

To the extent that the proposals or recommendations relate to the *Income Tax Assessment Act 1936*, we note that any legislative changes should be implemented into the *Income Tax Assessment Act 1997* as part of the re-write.

We trust that Treasury will find our comments and suggestions useful and we would welcome any feedback in this regard.