

# Tax Insight



## Prepare for new Australian tax reform directions

### At a glance

- ▶ Australia's Tax Forum resulted in a series of actions
- ▶ A Business Tax Reform Working Group has been announced
- ▶ Recommended reforms must be revenue neutral
- ▶ Ernst & Young CEO Rob McLeod is appointed to the working group
- ▶ Business must be prepared for changes and proactively involved in the process

### Rob McLeod, Ernst & Young Oceania CEO, appointed to Business Tax Reform working group

On closing the Australian Tax Forum, held from 4-5 October 2011, Australia's Federal Treasurer, Mr Wayne Swan, foreshadowed six initiatives, including a Business Tax Reform Working Group (the working group).

On 12 October 2011, Mr Swan announced the membership of the working group and its terms of reference - to consider reforms to the taxation of new investment in the Australian economy. The working group will:

- ▶ Consider the tax treatment of business losses; providing an initial report in mid-November 2011 and a final report in March 2012
- ▶ Assess options to reduce the corporate tax rate or alternatives such as allowances for corporate equity
- ▶ Identify options to fund any proposals from within the business tax system (without consideration of) GST

This will affect all Australian businesses. However the recommendations must be revenue neutral and funded by offsets elsewhere in the business tax system.

Ernst & Young welcomes business tax reform. Our [submission to the Tax Forum](#) highlighted reform priorities including reforming the tax loss rules.

Businesses need to be proactively involved in this reform process. In particular, businesses must prepare for the discussion of business tax changes which might lead to the withdrawal of tax benefits for some businesses.

## The Tax Forum

The Ernst & Young [submission to the Tax Forum](#) highlighted taxation reforms for consideration in the short term to support business development and restructure in a time of change. This included a review of tax loss rules and examination of lower tax rates, including transparent consideration of and allowance for corporate equity (ACE). Ernst & Young's [earlier joint submissions](#) identified business tax and tax rate reform priorities including:

- ▶ Indirect taxes, with major implications for state taxation
- ▶ Other consumption taxes including GST
- ▶ Individual and family taxes, welfare and workforce participation
- ▶ Governance and administration of a tax system which needs greater certainty

Treasurer Wayne Swan foreshadowed action on various proposals in his closing comments, including the creation of a Business Tax Reform Working Group to report on:

- ▶ Longer term directions for Australia's corporate tax
- ▶ Tax reforms for business in the 'patchwork economy' including treatment of tax losses
- ▶ "Savings options to fund any ideas ... from the business tax bucket"

## The Business Tax Reform Working Group terms of reference

The working group, formally appointed on 12 October 2011, will be chaired by Chris Jordan, the Chair of the Board of Tax. The working group includes Rob McLeod, CEO of Ernst & Young Australia and Oceania, who has led major tax reform initiatives in New Zealand. Other members include Jennifer Westacott, Chief Executive of the Business Council of Australia, Jeff Lawrence, Secretary of the Australian Council of Trades Unions and Frank Drenth, Executive Director of the Corporate Tax Association of Australia. The working group is to consult widely and make recommendations on improvements to the Australian business tax system in two stages.

Its recommendations must be revenue neutral however; the working group **must recommend offsetting business tax increases to fund its reform recommendations**. The recommendations must support productivity in the economy and not include any change to GST.

### Initial stage

The working group must first consider reform of Australia's business tax loss rules, with a draft report presented by mid November 2011 and a final report submitted by March 2012. This report is to include details of offsetting budget savings from business taxes, including analysis of the options, evidence of effectiveness and suitable revenue integrity provisions, not including changes to GST.

### In the longer term

The working group will investigate the potential for a lower headline corporate tax rate or to introduce an allowance for corporate equity (ACE) to the Australian tax system, reporting in 2012.

An ACE provides an additional tax deduction on an amount equivalent to a 'return' calculated on the 'equity' invested in a company, similar to the current deduction for interest payments. The concept is to tax only profit derived over and above the normal 'return' (known as the 'economic rent') with an attempt to create equivalent tax treatment of debt and equity. The normal return on equity would effectively become an adjustment for tax, reducing tax payable on a given level of accounting profit. The extent of the reduction is determined by the interplay between the profit derived and the extent to which it is funded by equity. These concepts give rise to challenges in practice.

## Tax reforms to be funded from within the business tax system

The working group “will also be required to identify options to fund any proposals from within the business tax system”, so will inevitably consider the reduction of some existing tax benefits. This becomes significant given that some participants in the Tax Forum highlighted the potential for Australia to increase tax revenues by:

- ▶ Adjusting Australia’s thin capitalisation rules for cross-border investment, both inbound and outbound
- ▶ Reducing accelerated depreciation on capital equipment which attracts concessional depreciation rates, specifically oil and gas capital equipment

Treasury and other submissions will doubtless recommend other savings in the business tax segment.

## Other reform initiatives foreshadowed

The Treasurer foreshadowed other initiatives at the Tax Forum as follows:

- ▶ A working group to develop a state tax reform plan for consideration in 2012
- ▶ An Advisory Board to add to governance for the Australian Taxation Office
- ▶ A review of the scope to reduce complexity for small business
- ▶ Funding academic research into improving the tax and transfer system
- ▶ Moving, eventually, the tax free threshold from the current \$18,000 to \$21,000

The Treasurer also acknowledged the need for improved tax law consultation processes.

## Action required by business

Businesses need to engage with the working group and the community. In particular, businesses should consider:

- ▶ Desirable improvements to the business tax system
- ▶ The impact of an ACE compared with lower corporate tax rates more generally
- ▶ Their position on any corresponding tax funding measures which might be suggested

## How Ernst & Young can help

Ernst & Young can work with you to develop your strategy and assist you to understand the reform proposals and their implications for your business. We can help you draft submissions to the working group and ensure your business needs and concerns are taken into account in the reform process.

For more information, please contact your Ernst & Young tax client service team or our Tax Policy Services group, led by Alf Capito. You can also view further information on the Australian Tax Forum and our involvement on our [website](#).

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