The Institute of Public Accountants

Pre-Budget Submission 2014-15

February 2014

IPA INSTITUTE OF PUBLIC ACCOUNTANTS

Partnership beyond numbers

Introduction

The Institute of Public Accountants (the Institute) welcomes the opportunity to present our pre-Budget submission for the 2014-15 financial year and looks forward to working with the Government as it sets its economic agenda.

The Institute is one of the three professional accounting bodies in Australia, representing over 26,000 accountants, business advisers, academics and students throughout Australia and in 57 countries worldwide. The Institute prides itself in not only representing the interests of accountants but small business and their advisers.

The Institute takes an active role in the promotion of policies to assist the small business and SME sectors, reflecting the fact that two-thirds of our members work in these sectors or are trusted advisers to small business and SMEs. The Institute is a member and supporter of the Council of Small Business of Australia and endorses this group's view that small businesses are not merely small versions of large businesses. The Institute also pursues fundamental reforms which will result in easing the disproportionate regulatory and compliance burden placed on small businesses.

This submission has been prepared in the context of the Institute's ongoing advocacy on behalf of Australia's small business community. The Institute's work continues to focus on responding to the many and varied pressures faced by small business owners/operators.

Australia has an enviable growth record but is facing some significant economic policy challenges, including an ageing population, slowing productivity growth, a mining boom that has reached its peak and rising unemployment. A strong and vibrant small business sector can play an active role in contributing to the economic growth of the Australian economy and help in addressing some of these challenges.

The Institute is accordingly very strongly of the view that immediate and tangible incentives must be offered to entrepreneurs and innovators to encourage their entry into and long term engagement with the Australian small business sector. The Federal Government needs to implement policies that will drive business activity and entrepreneurialism across all sectors.

In particular, we believe significant economic growth will occur if there is a more supportive regulatory environment and tax policy is a critical part of the regulatory environment for small business owners. With this in mind, the IPA welcomes any opportunity in assisting the Government in formulating its terms of reference for its white paper on tax reform. Whilst the Commission of Audit will focus on identification of waste and inefficiencies, a long term reform agenda for tax is long overdue.

We welcome the opportunity to discuss our recommendations in more detail with the Government and Treasury. Please address all further enquires to our General Manager – Technical Policy, Tony Greco tony.greco@publicaccountants.org.au or (03) 8665 3134.

Yours faithfully

Andrew Conway FIPA

Chief Executive Officer

Institute of Public Accountants

Table of Contents

Executive Summary

The Institute has proposed a number of policy initiatives and recommendations; the core of which relate to taxation, superannuation and financial services. We acknowledge the difficulty the Government has in balancing short and medium term policy goals in preparing the 2014-15 Federal Budget. Nonetheless there exists the opportunity in this year's Budget to introduce well targeted policies that are geared towards supporting a stronger and more prosperous economy into the future.

The following sets out the IPA's views and recommendations that the Government could consider in framing its priorities for the 2014-15 Federal Budget.

Taxation

Australia has experienced structural deficits for last five years which have been masked by the mining boom and Global Financial Crisis (GFC). Recurring structural deficits inevitably lead to higher levels of debt which will limit the ability of Governments to respond to future economic downturns.
Our tax system which has served us well in the past now needs to be reformed in order to meet the challenges that lie ahead. The Government needs to make its case for tax reform as public understanding is required to accept the size of the problem and the need to take action. Public acceptance is made easier if the burden is shared across the community. Hence the importance of the Governments promised tax white paper which will be taken to the next Federal election for Australians to consider. The Government needs to take into account all the existing analysis such as the Henry Review to create a blueprint that moves beyond the technical debate. Tax reform is an opportunity to improve lagging productivity and may represent one of the best levers the Government has to address many of its challenges.

Our current tax system is heavily weighted to taxes which place a comparatively high burden on economic growth, so reform is critical to Australia maintaining its enviable growth record.

Tax reform has now been elevated to one of the top structural problems facing our economy and the commitment to white paper represents an opportunity to advance much needed tax reform.

Taxation related recommendations focus on the following:

- that the Government adopt a concessionary rate of tax for small business to assist and support this important employer through a differentiated concessionary rate of tax on business income.
- that the Governments white paper on tax reform has broad terms of reference to include the important reforms highlighted in the Henry Tax Review that must be addressed in order to remove impediments to growth and entrepreneurial activity.
- that the taxation treatment of employee share schemes be improved for start up companies by deferring the taxing point to when securities are realised.
- that the Fringe Benefits Tax (FBT) laws remain in need of urgent review in order to ensure that the regime is consistent with contemporary business practice and to reduce the cost of compliance. Significant business cost savings can be made with little impact on government revenues.
- that the costs of financial planning advice fees be subject to a capped deduction. The Institute believes this measure would considerably increase consumer access to affordable financial advice and ultimately result in reduced consumer reliance on government provided benefits on retirement.
- that a loss carry back regime be re-introduced to assist with the survival of viable small business entities

Legal privilege

The Institute believes that Australia should move into line with other industrialised nations by extending legal privilege to registered tax agents. This reform has been recommended by the Australian Law Reform Commission.

Superannuation

The Institute believes there should be a comprehensive review of the benefits payments in the superannuation system. In particular a review of post-retirement payments including incentives for income streams and the development of annuity type products is warranted. This review must include the current taxation arrangements for lump sum draw downs to ensure long lasting and equitable funding of retirement. The Institute also supports more generous concessional contribution rules for older Australians.

Standard Business Reporting

The Institute is a strong supporter of Standard Business Reporting (SBR) and its benefits for a range of stakeholders, particularly small business. We urge the Government to maintain adequate funding for the SBR initiative. As awareness grows, the rate of take up will increase. The release of more SBR-enabled software, especially by larger vendors, will also favourably impact take up levels.

List of recommendations

Taxation

Recommendation 1.1: That the Government introduce a concessionary rate of tax for small business income to take into account the regressive regulatory burden imposed on small business and to reward entrepreneurial activity.

Recommendation 1.2: That the Government introduce legal privilege for registered tax agents.

Recommendation 1.3: That the Government carries out its commitment for a promised tax white paper. The terms of reference for the white paper should be broad and include the GST as part of the mix. The tax reform white paper needs to draw on all the existing work already undertaken including the Henry Tax Review and Tax Forum in formulating a blueprint to prepare our economy for the challenges ahead.

Recommendation 1.4: That the Government review FBT legislation to more fully recognise modern business practices and to reduce the small business regulatory burden.

Recommendation 1.5: Reintroduce the ability for companies to claw back tax paid when they incur revenue losses. The loss carry-back provisions recently introduced struck the right balance between allowing losses and limiting the exposure to government revenues by placing a quantitative cap in conjunction with a two-year carry-back period.

Recommendation 1.6 Review the taxing point at which share options are taxed particularly for small business start-ups. Securities provided by companies that meet certain eligibility criteria should have the option of deferring the ESS taxing point to when the securities have been realized and are able to be traded. By deferring the taxing point it avoids the need to value the shares when they are granted and also provides the employee with the funds required to pay the resulting tax on any discount given.

Recommendation 1.7: That the Government considers the adoption of a small business entity that has features relevant to the small business community as part of its ongoing efforts to streamline and reduce regulation and red tape for small businesses. That the Government also considers reviewing tax flow-through treatment options for small businesses operating through separate structures.

Recommendation 1.8: That the tax deductible costs of BAS preparation are limited to those incurred for the services of registered BAS agents.

Recommendation 1.9 Introduce a capped limit on deductions for financial planning advice to boost accessibility and affordability.

Other Taxation Recommendations

Recommendation 2.1 The Institute requests that the Government implement a legislative amendment to restore the previous position which existed prior to the change in ATO administrative practice. Proposed amendment:

- would be relatively simple to draft, and therefore could be enacted relatively quickly;
- aligns the treatment of the present entitlement rules with the provisions requiring resolutions making beneficiaries specifically entitled to capital gains to be completed by 31 August;
- is consistent with the extension of time provided to private companies. This rule recognises, and accommodates, the practical difficulties faced by SME companies in finalising financial statements before 30 June; and

- a sensible mid-point between the date of 31 October at which individual beneficiaries are required to lodge their income tax returns and the 30 June income tax year end.

Recommendation 2.2: That the Government re-visits the introduction of a taxation discount for interest income.

Recommendation 2.3: That the alienation of personal services income rules be reviewed to take into account modern work arrangements, low levels of compliance and uncertainty.

Recommendation 2.4: That the variation permitted on PAYG instalments be increased prior to the application of GIC.

Recommendation 2.5: That Division 7A provisions be written into ITAA 1997 in a simpler and clearer manner to minimise the compliance burdens placed on small businesses using trust structures. Division 7A provisions should be amended to provide certainty, especially with respect to whether UPEs are to be considered deemed loans under Division 7A. If UPE's are to be deemed loans, consideration should be given to allowing trusts to retain such funds for working capital without requiring minimum repayments.

Recommendation 2.6: That the Government increase efforts to assist the states and territories in achieving reform, including harmonisation of state and territory taxes.

Recommendation 2.7.1: Recommend that the current GST adjustment provisions be replaced with simple arbitrary adjustment provisions.

Recommendation 2.7.2: That the margin scheme provisions should be replaced with a simpler and more streamlined alternative policy model that achieves broad policy aims.

Superannuation and Financial Services

Recommendation 3.1: That the annual concessional contribution caps be amended as follows:

- For those aged 50 to 60 years: $50,000
- For those aged over 60 years: $75,000

Recommendation 3.2: Reintroduce the Low Income Superannuation Contributions (LISC) to ensure low income earners are not disadvantaged by having their earnings directed to their superannuation funds

Recommendation 3.3: Repeal legislation that prohibits a personal concessional member contribution where the member earns more than 10 per cent of their income from employment services.

Recommendation 3.4: Repeal the relevant legislation that prohibits contributions to a superannuation fund by Australians aged 65 or over if not gainfully employed on at least a part time basis.

Recommendation 3.5: That the recommendations in the Henry Review in relation to annuity and deferred annuity products be adopted to encourage the use of annuity and other life pension products upon retirement. A post-retirement products review should also encompass taxation arrangements for lump sum payments and the development of annuity type products

Recommendation 3.6: That legislation relating to LRBAs be amended to remove the requirement for the single acquirable asset to be held on trust so the superannuation fund trustee obtains a beneficial interest.

Recommendation 3.7: The small business superannuation clearing house should be brought under the jurisdiction of the ATO as proposed by the government.

Recommendation 3.7.1: The threshold with regard to staff numbers eligible to use the small business superannuation clearing house should be increased from 19 to 100.

Recommendation 3.7.2: Another reporting option should be incorporated into the quarterly BAS to allow superannuation payments to be made to the ATO for it to pay into members' superannuation funds.

Other Matters

Recommendation 4.1: That the Government maintains funding for the SBR program to ensure benefits are realised.

1.0 Taxation

1.1 Concessionary tax rate for small business income via tax offset

As the engine room of the economy, small business would benefit from a differential rate of income tax to compensate for their disproportionate regulatory burden.

With the exception of Capital Gains Taxation (CGT) concessions, most small business tax benefits currently merely provide for a deferral of tax; a marginal benefit at best.

Only those small business owners able to sell business assets at a profit are able to enjoy CGT tax concessions at the time of "exit".

The concessions currently available to qualifying businesses at the time of exit should be redistributed and applied at start up and in the subsequent growth years.

Small business income earned by individuals is subject to the same progressive tax rates as individuals; the majority of whom do not have the same regulatory burdens or exposure to risks.

The level of taxation compliance and complexity facing small business has increased substantially over the last few decades. With the introduction and development of Fringe Benefits Tax (FBT), CGT, Goods and Services Tax (GST), the paid parental leave scheme and compulsory superannuation, our taxation system has become excessively onerous and more than 95 per cent of businesses currently engage a tax practitioner. Tax compliance is in addition to the already heavy burden faced by small business in administration and reporting relevant to workplace and OH&S laws, and the superannuation guarantee.

The Institute proposes a concessionary rate of tax for small business income to compensate for the regressive nature of compliance costs and to reward entrepreneurial activity. The small business income component of an individual's total income should receive a tax offset to reduce the effective tax rate on small business income. All other income would be subject to existing tax rates. A lower tax rate would be more equitable, efficient and cost effective.

The proposal would operate on a similar basis to the entrepreneurs tax offset (ETO), which was recently abolished. This measure was originally intended to offer an incentive to small business in the early stages of development by way of a tax offset of up to 25 per cent for those with a turnover of less than $75,000.

There is evidence to support the proposition that the majority of small businesses would prefer a lower tax rate and a simpler system than a plethora of complex tax concessions which they may not be able to fully access. The existing small business turnover threshold of $2 million would determine eligibility. The current anti-avoidance rules provide the necessary integrity measures to discourage larger businesses from being separated into smaller entities to take advantage of a lower rate.

Measures to help fund the proposal

The removal of a host of existing small business tax concessions will help fund this initiative of reducing the tax rate applying to small business income. These would include:

- Rationalising and streamlining the CGT concessions recommended by the Henry Review. The four current and separate small business CGT concessions require taxpayers to navigate complex legislation. A number of existing concessions; such as the 50 per cent reduction and the 15 year exemption are highly concessional, and can eliminate any CGT liability when business owners exit their investment. These concessions are generally uncapped. Evidence suggests that only a small number of owners are able to sell business assets at a premium and take advantage of this concession.
- A review and rationalisation of other small business income tax concessions.
- A review of existing FBT concessions to enhance efficiency and equity. The use of uncapped FBT exemptions for restaurant meals and the hire of entertainment facilities for private

purposes by relatively high income professions costing revenue hundreds of millions of dollars and goes well in excess of original policy intent.

The ETO framework is already in place (or can be easily re-introduced) and provides the administrative capability to implement this proposal in a relatively short timeframe. The proposal represents targeted assistance to the largest employer group in Australia and will boost productivity and employment.

The proposal has the potential to be revenue neutral by limiting the concessions to the cost savings noted above and/or applying an income test eligibility threshold.

Recommendation 1.1: That the Government introduce a concessionary rate of tax for small business income to take into account the regressive regulatory burden imposed on small business and to reward entrepreneurial activity.

1.2 Legal privilege for tax advice

The Institute supports the extension of legal privilege to tax advice provided by professional tax advisers.

In 2007, the Australian Law Reform Commission conducted an inquiry into the operation of legal professional privilege in relation to the coercive information gathering powers of various Commonwealth bodies. The report recommended the establishment of tax advice privilege to protect advice given by independent professional accounting advisers from the coercive information-gathering power of the Commissioner of Taxation.

In response to this report in April 2011 the Government issued "*Privilege in relation to tax advice".* The Government has yet to make any recommendations.

Australian taxation law is complex, and the self-assessment system requires tax payers to have a good understanding of their rights and obligations before they can make an assessment of their tax liability. This justifies why the tax legislation makes allowance for accountants to give legal advice on taxation law.

Overseas precedent for extending legal privilege to accountants; indicates Australia is out of step. Consumers seeking independent and objective taxation advice must have access to legal protections and safeguards irrespective of whether they seek the advice from a lawyer or from an accountant.

The ATO has a non-statutory administrative arrangement ("accountant's concession") that provides a narrow and restrictive form of legal protection which in the Institute's view is inadequate. Extending legal privilege to tax advice would give the accountant's concession legislative force. A recent case confirmed that the accountant's concession cannot be claimed over documents that have come into possession of persons other than the taxpayer or adviser from which they are sought by the ATO.

The Institute's preferred model extends legal privilege to registered tax agents who are members of professional accounting associations; on the basis that members of professional accounting bodies are qualified accountants who have undertaken further studies, hold a practicing certificate and are held to higher professional and ethical standards than non-members.

If the Government is not minded to add this qualification; the Institute believes that at a minimum, legal privilege should be extended to registered tax agents.

Recommendation 1.2: That the Government introduce legal privilege for registered tax agents.

1.3 Tax reform blueprint rather than piecemeal reviews with revenue neutral outcomes

Our current mix of taxes limits Australia's growth potential. A shift to growth supporting taxes is required to sustain Australia's economic momentum and meet all current and future spending needs. The current taxation mix is insufficient to meet expenditure commitments and Australia faces a revenue funding gap.

The Henry Review provided a comprehensive 'blueprint' for the future of our tax system. The recommendations of this review must now be developed into detailed, workable and affordable long term reform strategies.

Recent tax reform initiatives have been divided into discrete reviews, requiring each to be considered in isolation with an overall revenue neutral outcome. Tax reform in this manner will miss the synergistic benefits available from wider tax reform opportunities.

Company tax rate reduction, trust re-write, Division 7A and tax concessions for the Not-for-Profit sector, all fall into this revenue neutral category. The revenue neutral outcome dictated in the terms of reference of these reviews severely impacts the quality of the consultation process and outcomes. Most of these reviews will be hamstrung by narrowly defined terms of reference.

The Henry Review sought to address some of the fundamental imbalances that exist within the current system. The existing tax mix will struggle to achieve revenue adequacy in the long term in the face of rising expenditures as the population ages and workforce participation declines. Consumption taxes, being the most efficient and sustainable of taxes, are widely regarded by tax policy experts and others as integral to reshaping Australia's future tax reform agenda.

As recommended in the Henry Review, nuisance taxes should be removed and our reliance on income tax decreased; with a shift towards greater reliance on consumption taxes which will encourage savings and investment and provide a more sustainable source of revenue. Most nuisance taxes which are inefficient, distortive and inequitable are levied by state governments; and reform in these areas will require an examination of the adequacy of state and territory revenues.

As noted on numerous occasions by this Institute, the base and rate of GST must be included in any discussion of tax reform. Consumption taxes such as the GST represent one of the most efficient and sustainable tax bases available.

Australia's GST base is relatively narrow and covers less than 60 per cent of private consumption. In addition, the GST rate is relatively low compared to the OECD average of 18 per cent. A review of the base and rate of GST should be an option for addressing the fiscal imbalance between Federal and state governments. Australia's GST covers about 60 per cent of a comprehensive consumption tax base which gives Australia the seventh lowest coverage ratio amongst 32 OECD countries.

GST revenues have grown over time and represent a more robust and stable source of revenue than income taxes; the latter of which are more vulnerable to changed economic conditions.

It is acknowledged that the regressive nature of GST will mean that appropriate compensatory measures for low income households will be required if rates are increased. Any increase in the base or rate will need to be accompanied by increased welfare payments to mitigate the effects on those worst off.

It is noted that reform will only be possible if the case for change begins now and well ahead of implementation. The Institute believes that it is important for an open, mature debate on this issue.

There must be a shift of the tax burden to less mobile and less growth-damaging bases to support economic growth and meet spending needs. All taxes represent a drag on economic growth but the GST does not discourage earnings or investment nearly as much as income and corporate taxes.

The mining boom has masked structural deficits. Now that the boom has receded there will be a need to revert to the non-mining sector which is already exposed to higher rates of tax.

The Henry Review and the Tax Forum have provided a strong foundation to progress tax reform and the ability to commence the process of discussing recommendations to build support for a long term tax reform plan. We note that the Government has promised a tax white paper in its first term to review the tax system and has not ruled out the GST as part of its terms of reference.

Recommendation 1.3: That the Government carries out its commitment for a promised tax white paper. The terms of reference for the white paper should be broad and include the GST as part of the mix. The tax reform white paper needs to draw on all the existing work already undertaken including the Henry Tax Review and Tax Forum in formulating a blueprint to prepare our economy for the challenges ahead.

1.4 Fringe Benefits Tax Overhaul

A comprehensive review of FBT legislation is required. Since its introduction in 1996 there have been significant changes to the workplace that cannot be accommodated by the existing legislative framework and recent legislative changes constitute a 'band aid' approach to addressing systemic FBT problems.

Any review of FBT must address compliance issues facing small business.

FBT is an inefficient tax, intended as a disincentive, rather than a source of revenue.

FBT incurs the highest compliance cost relative to the revenue generated and there is considerable scope to reduce the compliance burden on small businesses; including the small Not-for-Profit (NFP) organizations.

It is noted that the previous Government commenced a review into the tax concessions to the NFP sector; including FBT concessions and has created the NFP Tax Concession Working Group to look into fairer, simpler and more effective tax concessions for the sector.

Whilst this review into the NFP sector is laudable, it provides an ideal opportunity to expand the review to consider broader FBT reform.

The FBT valuation and apportionment methodologies impose unnecessary compliance costs on small employers. Salary packaging arrangements add to administration and increase recording and reporting requirements.

The complexity of the FBT system is exacerbated by the fact that the incidence of the taxation of fringe benefits falls on employers. The taxation of fringe benefits to employers requires supplementary rules to ensure fringe benefits are factored into the various means tests in the tax and transfer system; such as family tax benefits and parenting payments.

In many overseas jurisdictions, fringe benefits are taxed in the hands of employees. It is the Institute's view that the taxation of fringe benefits at the employee level has the potential to deliver greater neutrality in the treatment of cash and non-cash remuneration; whilst simultaneously reducing compliance costs for all parties.

Benefits that can be readily valued and assigned to an employee should be taxable in the employee's hands and reportable for transfer purposes.

The taxation of fringe benefits in the hands of employees would also alleviate the inequitable application of the top marginal tax rate to fringe benefits, which is currently applied irrespective of the income of the employee.

The Henry Review supports the transfer of FBT to employees.

Other benefits incidental to an individual's employment or otherwise difficult to assign, should be taxable to the employer. This approach would provide a more neutral taxation outcome by removing the need for the current grossing–up process and would facilitate the consistent and equitable treatment of fringe benefits for means tested taxes and transfer payments.

Other FBT issues:

- The adoption of caps on FBT concessions for public benevolent institutions (PBI) and certain other NFP organizations: Of particular concern is the grossed-up taxable value concession of $17,000 for public and NFP hospitals and $30,000 for non-hospital PBI's, excluding meal entertainment. There is currently no upper limit on the FBT concession for meal entertainment for these entities and salary packaging providers are actively promoting the use of meal entertainment for dining and holidays. The concessional FBT treatment for meal entertainment for these entities should have an upper limit to avoid abuse.
- FBT and childcare: An FBT concession exists for childcare provided by an employer on their business premises. This concession is currently only available to a small number of larger employers. The concession should be extended to childcare provided on premises other than those of the employer.
- FBT and long service leave exemption: The FBT concession that applies to a long service leave for service of 15 years or more exempt awards if not more than $1,000 plus $100 for each additional year of service. The exception ceases to be exempt if the award exceeds the applicable limits. The exemption should apply to the applicable exempt amount and any excess should only be subject to normal FBT rules.
- The use of the top marginal tax rate as the FBT default rate can lead to inequity. The Henry Review recommended that where the benefit is easily identifiable to an individual, this benefit should be taxed in the individual's tax return at the individual's marginal rate.
- The current taxation system for cars which consists of stamp duty and FBT is a financial disincentive for best practice for safety and fuel/emissions reduction strategies. Vehicles which have additional safety features or are environmentally friendly are penalised as these features generally incur additional costs which are subject to stamp duty and FBT.
- Compliance issues caused by recent changes to living away from home allowances.

Recommendation 1.4: That the Government review FBT legislation to more fully recognise modern business practices and to reduce the small business regulatory burden.

1.5 Reintroduce loss carry-back regime

At the time of writing, there was a Bill tabled before Parliament which intends on removing the Minerals Resource Rent Tax (MRRT) and to discontinue certain tax measures that were intended to be funded by the MRRT. Whilst we acknowledge that the repeal of the MRRT will result in changes in a number of other tax measures which were to be funded from revenue expected from the MRRT, we are particularly disappointed with the repeal of one of those tax measures; namely, the loss carry-back provisions in the income tax laws.

Loss carry-back allows companies to offset current period losses against previously paid taxes. The loss carry-back provisions recently introduced struck the right balance between allowing losses and limiting the exposure to government revenues by placing a quantitative cap in conjunction with a two-year carry-back period. The quantitative cap reduces the government's exposure to large losses incurred by eligible companies. Both the Henry Review and Business Tax Working Group recommended the adoption of loss carry-back.

Australian businesses are under pressure to adapt and change their business models to overcome challenges and make the most of opportunities arising from structural changes underway within the economy. It is for this reason that the tax system should encourage rather than get in the way of businesses wanting to invest and innovate. Without loss carry-back, our tax system penalises investments that have some risk of failure through its treatment of losses. This penalty against risk taking can influence the kinds of investments undertaken and how much investment occurs which can impact on productivity and employment.

Small businesses operating through a corporate structure that experience a sudden downturn would receive invaluable cash flow benefits to help them ride out any economic downturn caused by external factors such as the Global Financial Crisis (GFC). Loss carry-back will help assist the continual survival of viable companies during similar downturns in future years.

While recognising that businesses operate through a range of legal structures, loss carry-back only helps small entities that operate using a company structure. Nonetheless, there are 760,000 small business entities that could benefit from having loss carry-back as part of our tax system. It could be the difference between being able to survive a tough year as it provides an important boost to cash flow when it is needed most and at a time when it is most critical in ensuring survival of the business.

Recommendation 1.5: Reintroduce the ability for companies to claw back tax paid when they incur revenue losses. The loss carry-back provisions recently introduced struck the right balance between allowing losses and limiting the exposure to government revenues by placing a quantitative cap in conjunction with a two-year carry-back period.

1.6 Employee Share Schemes

Changes to the tax rules in 2009 governing employee share schemes (ESS) effectively treat employee share options as income which is taxed at the employee's marginal tax rate. If no concessions apply, any discount on the market value of an interest in a share or right provided to an employee under an ESS is taxed as part of the employee's taxable income in the year it is acquired rather than on disposal.

Many overseas countries such as the UK, USA, Canada and Singapore generally defer the taxing point to when the securities are sold. This treatment puts a dampener on using share options for little or no upfront cost as a remuneration option for cash strapped entities trying to attract and retain talent.

If tax is paid by the employees and the value of the securities has fallen due to market forces, the employee is not eligible for a tax refund, but would instead have a capital loss under the capital gains provisions. This makes participation in an ESS an unattractive proposition especially when you consider the high failure rate of start up companies. The current ESS rules fail to recognize that unlike large well funded companies, start ups require employees to participate in long term equity incentives as they do not have cash to pay competitive salaries to incentivize employees.

Innovation is vital to a country like Australia which is transitioning away from its more traditional employment sectors to a digital economy. New innovative technology start-ups have the potential to generate new markets and significant employment growth. Without the cash flow to offer a competitive wage, an equity stake is the best option to attract and incentivize employees but the current rules make this strategy ineffective.

Encouraging the growth of innovative start ups is in the national interest as it can lead to benefits for the economy more broadly. ESS provider wider benefits to the economy as research has shown that employees involved in ESS have improved performance which can contribute to the growth of the business. In addition, Australian technology firms have made significant contributions to the ability of Australian firms in other industries to take advantage of the digital economy by providing the tools to do business online affordably and easily.

A more supportive regulatory environment for start ups could help address one of the main challenges of attracting and retaining experienced skilled employees faced by start ups. Other tax jurisdictions will only tax the gain when it is realised making Australia's system uncompetitive.

Last year, Treasury issued a discussion paper on ways to improve the current operation of ESS which called for submissions by 30 August 2013 acknowledging that the new rules could be improved to better support innovative companies. The consultation process for reviewing ESS rules was put on hold during the election. On 21 January 2014, Treasury announced a review of ESS for start ups which is a welcomed announcement to address current criticism of the rules.

Recommendation 1.6 ***Review the taxing point at which share options are taxed particularly for small business start-ups. Securities provided by companies that meet certain eligibility criteria should have the option of deferring the ESS taxing point to when the securities have been realized and are able to be traded. By deferring the taxing point it avoids the need to value the shares when they are granted and also provides the employee with the funds required to pay the resulting tax on any discount given.***

1.7 Simpler structure options and/or flow-through regime for small business to streamline and reduce regulation and red tape

One of the Institutes long term aspirational goals is the simplification of the small business taxation system through the application of a structure which eliminates the need for multiple structures. Multiple structures are commonly needed to achieve tax outcomes which would be otherwise unavailable through a single entity. A simplified small business entity regime can significantly reduce regulation and red tape for small businesses.

Small businesses seek measures which promote asset protection, the retention of profits for working capital, lower tax rates, access to CGT discounts, succession planning and income distribution. A combination of entities is generally used to achieve these outcomes. A typical example may be where a business operates through a partnership whose interests are held by a discretionary trust with a company among the trust beneficiaries. When a small business operates through separate legal structures; the current taxation system treats the structures as taxation entities separate from their owner(s); resulting in a quantum leap in tax compliance and complexity.

International evidence exists of entities specifically designed for small businesses. For example in the United States, small businesses may set up using an S-Corporation that offers a number of advantages such as asset protection and flow-through tax treatment. The creation of a new small business structure allows small business entities to use a single simplified structure rather than the current complicated ownership structures such as trusts. If such a structure allowed the optional retention of income at the corporate tax rate, it would allow most of the benefits that can currently be obtained via the use of a company and discretionary trust via a cheaper and simpler vehicle to administer. A simpler structure option could represent a better pathway to avoid the complexity that exists in relation to Division 7A and trusts.

As an alternative, entities that choose to retain a multiple entity structure should have the option to adopt flow-through taxation treatment. This option can significantly reduce the complexity of small business taxation.

The Ralph Review of taxation recommended this in 1999 as a way of providing small businesses with the benefits of a tax consolidation group without the compliance burden. The adoption of such a regime will allow SMEs flow-through tax treatment for commonly used entities such as companies or trusts.

A solution for SMEs would be to allow access to a flow-through regime when separate entities are used which effectively gives them the benefits of a tax consolidation regime without the complexity. The small business tax concessions do not deal with using structures and minimizing compliance.

Recommendation 1.7: That the Government considers the adoption of a small business entity that has features relevant to the small business community as part of its ongoing efforts to streamline and reduce regulation and red tape for small businesses. That the Government also considers reviewing tax flow-through treatment options for small businesses operating through separate structures.

1.8 Tax deduction for the cost of the services of a registered BAS agent

Taxpayers are currently able to claim a deduction under Section 25-5 ITAA 1997 for the costs of managing their tax affairs if this work is undertaken by a registered tax agent. Businesses are currently able to claim a deduction for the services of a registered BAS agent for BAS preparation. However, there is no legal requirement for businesses to use the services of a registered BAS agent.

Whilst the Institute recognises that the *Tax Agent Services Act* 2010 (TASA) imposes penalties for anyone offering BAS agent services without registering with the Tax Practitioners Board (TPB), the TASA does little to encourage small businesses to engage with registered BAS agents only. Many businesses are unaware that their use of an unregistered bookkeeper may result in exposure to penalties that would otherwise be avoided due to TASA's safe harbour consumer protection provisions.

The intent of the TASA was to protect users of BAS agent services from the risks associated with the appointment of unqualified or unskilled providers.

With only 16,256 registered BAS agents (figure as at 31 December 2013) servicing the small business community, it is apparent that many providers of bookkeeping services continue to operate unregistered. It is also noteworthy that the TPB has not yet prosecuted unregistered BAS agents.

Encouraging small business operators to deal only with registered BAS agents will flush out many of the providers who currently operate outside the regulatory environment and do not meet the minimum education and/ or experience requirements.

Small businesses unaware of the consumer protection benefits of TASA will be encouraged to secure the services of registered BAS agents in preference to unregistered providers.

Recommendation 1.8 That the tax deductible costs of BAS preparation are limited to those incurred for the services of registered BAS agents.

1.9 Tax deduction for financial advice

The Institute believes there is a strong case to support the tax deductibility of all of the costs of financial planning advice.

Currently, a fee for service arrangement for the preparation of an initial financial plan is not tax deductible under Section 8-1 of the ITAA 1997 as it is not considered to be an expense incurred in producing assessable income.

Tax Determination TD 95/60 issued by the ATO draws a distinction between a fee for (a) drawing up a financial plan and (b) fees for management or annual retainers. TD 95/60 states that any of the expense incurred in drawing up a plan is not deductible for income tax purposes because the expenditure is not incurred in the course of gaining or producing assessable income but is an expense of putting the income earning investments in place and therefore capital in nature.

However, ATO guidance in Taxation Ruling IT39 states that where expenditure is incurred in 'servicing an investment portfolio' it is incurred in relation to the management of income-producing investments, has an intrinsic revenue character and is therefore deductible.

Allowing initial fees to be tax deductible would considerably assist consumer access to affordable financial advice. As it stands, the absence of a tax deduction for these fees discourages many Australians from pursuing important strategic advice which will assist in their organisation of finances and financial independence. Increased financial independence will reduce demands on public funding.

The tax deductibility of initial financial plans would encourage larger numbers of Australians to seek financial advice.

It is estimated that 20 per cent of Australians currently use a financial planner. Recent changes to acceptable remuneration arrangements for the financial advice sector as part of the FOFA reforms will see advisers move from a commission based to a fee for service remuneration regime. Members of the professional accounting bodies are uniquely positioned to assist taxpayers in the organisation of their finances and to plan for retirement by providing independent and non-product specific advice when the new limited licensing regime commenced on 1 July 2013. Already more than

70 per cent of the population seeks the services of a tax agent for assistance. One of the policy intentions of FOFA is an improvement in consumer access to low cost, affordable financial advice and making the cost of advice deductible is consistent with this outcome. The new limited licensing regime provides an ideal opportunity for accountants to provide strategic non-product affordable financial advice to the community.

Tax deductibility carries a cost which will be significantly outweighed by the longer-term benefits of the assistance provided to taxpayers as they plan for independent retirement as well as improving financial literacy. The cost to government will not be significant as these costs were previously mainly deductible when planners were remunerated via commissions.

Recommendation 1.9 Introduce a capped limit on deductions for financial planning advice to boost accessibility and affordability.

2.0 Other taxation recommendations

2.1 Trustee resolutions

A trust compliance matter that has caused significant compliance issues to a large number of our members servicing SMEs is trustee resolutions. Since 30 June 2012, there has been a requirement for trustees to complete trustee distribution resolutions by 30 June each year. This change was brought about by the ATO on 1 September 2011 when it withdrew its long standing practice of allowing trustees an additional two months to prepare trust distribution resolutions. This administrative practice had been in place since 1966. It recognised the practical difficulties faced by trustees and their advisors in making trustee resolutions prior to the end of the financial and income tax year ended 30 June.

The ATO acknowledged this administrative difficulty in paragraph 31 of IT 328 of the now withdrawn administrative statement:

"Where a trustee is carrying on a business, it will be impossible to determine the amount of the net income of the trust estate until after the close of the year of income."

In recognition of that practical difficulty, which still remains almost 50 years later, the ATO allowed trustees and their advisors a two month extension until 31 August to draft appropriate resolutions. This enabled trustees and their advisors to draft trustee resolutions using completed financial statements.

The withdrawal by the ATO of this administrative practice meant that for the income tax year ended 30 June 2012 and thereafter, all trustees were strictly required to ensure that these resolutions were made by 30 June each year.

The compliance issues this causes can be summarised as follows:

- this additional work of estimating 30 June balances is *not otherwise required*, if a trustee is able to prepare its distribution resolutions on actual finalised accounts for the income year;
- no incremental commercial benefit flows to trusts and their advisors from requiring trustees to make trustee resolutions earlier. The additional work is *purely* a compliance issue. The change in ATO practice, however, meant that a lot more work was required in order to reach that same outcome;
- this increased work load arose and will continue to arise at a particularly busy time for SME groups and their advisors as they are also required to prepare at this time Business Activity Statements, group certificates and payment summaries, WorkCover reconciliation documents, Tax File Number withholding reports, and alot more 30 June compliance related documentation;
- advisors had to perform this additional work with full knowledge that, in this current difficult economic climate, many SME clients could not, or would not, bear the additional cost caused by the change of ATO practice. As a result some, or all, of the related time cost would have to be written off thereby reducing their income; and
- all these compliance issues are likely to cause similar compliance problems annually and into the future.

Recommendation 2.1 The Institute requests that the Government implement a legislative amendment to restore the previous position which existed prior to the change in ATO administrative practice. Proposed amendment:

- ***would be relatively simple to draft, and therefore could be enacted relatively quickly;***
- ***aligns the treatment of the present entitlement rules with the provisions requiring resolutions making beneficiaries specifically entitled to capital gains to be completed by 31 August;***

- ***is consistent with the extension of time provided to private companies. This rule recognises, and accommodates, the practical difficulties faced by SME companies in finalising financial statements before 30 June; and***
- ***a sensible mid-point between the date of 31 October at which individual beneficiaries are required to lodge their income tax returns and the 30 June income tax year end.***

2.2 Tax discount for interest income

The Institute has frequently advocated the concessionary treatment of interest income; the current tax treatment of which compares unfavourably with other forms of savings such as property and shares. A tax discount for interest income was planned to come into operation on 1 July 2013 in the form of 50 per cent discount for interest income capped to $500. This initiative was abandoned before its introduction.

It is noted that an uncapped 40 per cent savings income discount was recommended by the Henry Review in order to remove the inequitable treatment of interest income and to improve incentives for national savings.

Recommendation 2.2: That the Government re-visits the introduction of a taxation discount for interest income.

2.3 Alienation of personal services income

The rules surrounding the 'alienation of personal services income' (PSI) were introduced in July 2000; primarily to enable taxpayers to self assess as to whether they operate as a personal services business. Taxpayers unable to satisfy PSI rules would have their income attributed back irrespective of whether they operated through an interposed entity.

The rules were aimed at ensuring that PSI taxation applied equally regardless of the arrangements under which income is earned and that business deductions, income splitting and tax deferral are not available to entities not genuinely conducting a business enterprise.

Whilst we are supportive of the policy intent of the legislation, we believe the existing framework needs to be reviewed to provide more certainty, ease compliance and reduce complexity. The PSI rules are relevant for small businesses and therefore need to be clear, understandable and conducive to the average taxpayer being able to discharge their obligations with certainty. There is too much uncertainty as to the interpretation of key elements of the law.

The use of interposed entities is often a legitimate commercial means by which contractual arrangements can be satisfied. It should not be viewed prima facie as an attempt to engage in income splitting and/or tax deferral.

The following aspects should be further considered:

- *Simplify key elements of the law*: Too much uncertainty with respect to interpretation of key elements of the law which make compliance difficult. Individuals who endeavour to comply with the existing rules face difficulties interpreting terms such as the 'results' test in order to determine compliance.
- *Complex attribution rules and PAYG withholding obligations*: Although the ATO has in place a Practice Statement containing simplified methods to address PAYG compliance, there is still room for streamlining. Reviews into the current system have shown low levels of compliance with existing PSI rules; indicating a systemic issue with legislation. The contractor reporting rules which came into operation last financial year will target the construction industry before wider application. This initiative will highlight deficiencies within the system; particularly the widespread non-reporting of income. Contractors generally report their ABN to clients. However, clients are currently under no obligation to report the fee income paid during a year to the ATO.
- *Payments to associates for non-principal work for entities that cannot prove they are personal services businesses:* This is a harsh outcome when essential services are performed by an

associate and would be otherwise fully deductible if paid to a third party. There needs to be scope for deductibility of legitimate costs subject to integrity measures which ensure charges are at arms length.

- *Provide more certainty*: This is especially relevant for taxpayers who pass the existing test and whether they are able to income split and/or defer tax by allowing income to be retained within the entity. There appears to be a lack of understanding regarding the interaction between the PSI rules and the general anti-avoidance provisions (of Part IVA).
- In certain circumstances and for commercial practices the rules are inflexible.
- The distinction between PSI and income generated from a business structure is becoming increasingly unclear and the current framework hinders differentiation.

To promote economic growth, Australia requires a tax system which is consistent, cognisant of commercial reality and encourages productivity. Accordingly our taxation system should acknowledge the real benefits of contracting arrangements. The Henry Review has called for a revision of the rules and an extension of the PSI scope to cover all entities earning a significant proportion of business income from the personal services of their owner/managers.

Recommendation 2.3: That the alienation of personal services income rules be reviewed to take into account modern work arrangements, low levels of compliance and uncertainty.

2.4 PAYG instalments variations

There are significant disincentives when considering varying PAYG instalments. If the actual tax payable is greater than and differs by more than 15 per cent of the varied instalment, a general interest charge (GIC) is payable on the discrepancy. As a consequence, the low margin for error acts as a deterrent against varying instalments downwards to improve cash flow. The result has however been that entities often choose to overpay PAYG instalments knowing full well that their instalments will be excessive and lead to a refund. No interest is payable to the taxpayer and no consideration given to the opportunity cost.

Recommendation 2.4: That the variation permitted on PAYG instalments be increased prior to the application of GIC.

2.5 Rewrite of Division 7A to enhance certainty

The Division 7A requirements are integrity provisions that treat all payments, loans, and debt forgiveness by private companies to shareholders (or associates) as assessable dividends (unless within specified exclusions), to the extent there are realised or unrealised profits in the company.

Division 7A also ensures that a trustee cannot shelter trust income at the prevailing company tax rate by creating a present entitlement to a private company without paying and by then distributing the underlying cash to a shareholder of the company (or an associate).

Since Division 7A was enacted, there have been a significant number of piecemeal legislative amendments to a point where the provisions have become excessively complex and created unnecessary compliance problems.

Division 7A continues to confound practitioners. The time has come to rewrite these provisions into the ITAA 1997 to streamline their operation and remove uncertainties.

This is particularly important since the release of Taxation Ruling TR 2010/3 which sets out the Commissioner's view on when a private company with an unpaid present entitlement (UPE) from an associated trust is considered to have made a loan for Division 7A purposes.

This ruling effectively brings UPEs to corporate beneficiaries into the Division 7A net and turns them into deemed dividends unless corrective action is taken. This is achieved by extending the definition of a loan to include financial accommodation.

Trusts have been a long standing and legitimate structure chosen by many families and businesses, principally for asset protection and flexibility. UPEs have been in existence for many years and the overwhelming view (and policy objective) was that UPEs were not loans. It is not uncommon in many family structures to have a company as a beneficiary of a trust. The trust makes the company beneficiary presently entitled to the income but the money stays within the trust for commercial purposes. This has been long standing commercial practice recommended by practitioners. The long standing view has been not to treat these UPEs as loans unless the trust lends the money to a shareholder or their associate. Subdivisions EA and EB of Division 7A would apply in the manner in which they were originally intended.

The Institute believes the Government should remove uncertainty by determining whether it will adopt the ATO's revised position and make the requisite legislative amendments to Division 7A as a matter of policy. If the Government's policy intent is to extend Division 7A to UPE's, it needs to consider more commercially acceptable options with respect to repayment of loans than are currently available under ATO guidance. The current ATO administrative practices contained in PS LA 2010/4 provide three investment options; with the majority of taxpayers choosing option 1 or 2. Both these options require repayment of the principal at the end of 7 or 10 year terms respectively.

We acknowledge that the Board of Taxation (BOT) is currently undertaking a post-implementation review of Division 7A of the ITAA 1936 to determine whether the legislation is operating as intended and whether it can be improved to reduce compliance costs. The Assistant Treasurer has recently announced that the BOT will extend its review of Division 7A to include the broader tax framework in which private business operates. The extension of the review of Division 7A highlights the complexities that can arise because of the Division's interaction with other areas of the tax code and its operation in the context of private group tax arrangements.

One of the three reform options in the BOT discussion paper is to allow loans with no repayment terms. The IPA believes that there is justification for exclusion from Division 7A of loan funds that are not used for private purposes but are used as working capital or for investment (excluding passive investments) in the business.

Recommendation 2.5: That Division 7A provisions be written into ITAA 1997 in a simpler and clearer manner to minimise the compliance burdens placed on small businesses using trust structures. Division 7A provisions should be amended to provide certainty, especially with respect to whether UPEs are to be considered deemed loans under Division 7A. If UPE's are to be deemed loans, consideration should be given to allowing trusts to retain such funds for working capital without requiring minimum repayments.

2.6 Federal, state and territory tax reform

The Government should work with the states and territories to increase the efficiency and harmonisation of state and territory tax structures.

The Institute suggests the following key reform measures:

- Continued reassessment and realignment of the allocation of responsibilities between Federal and state bureaucracies with the aim of improving accountability, efficiency and reduction in public sector waste.
- The most inefficient taxes levied by federal, state, territory and local governments should be removed. The Henry Review has already identified a large number of inefficient taxes levied across taxing jurisdictions and proposed alternative funding arrangements to recover lost state-based revenues. The Henry Review considers other efficient broad-based taxes but its terms of reference excluded increasing the scope and rate of GST. The exclusion of the GST represented a missed opportunity to tackle the big issues confronting our tax system. The Institute and others have reiterated this position on a number of occasions. Any serious overhaul of inefficient and market-distorting state taxes (such as stamp duties or insurance taxes) brings with it a need to replace foregone revenue. Given GST revenues are already passed to state governments pursuant to the 1998 inter-governmental agreement, and the fact that the GST is an inherently more efficient tax, it would be preferable to closely review

the option of expanding the existing base of goods and services currently subject to the GST and to review the GST rate. Consumption taxes such as the GST have the compelling advantage of improving productivity by eliminating duplication, cutting waste and allowing states to retire inefficient taxes such as stamp duties and the like.

The Institute is encouraged by the ACT's progressive approach to the removal of inefficient taxes such as stamp duty on property conveyances and the duties on general insurance. It is noted that, as recommended in the Henry Review, the ACT will increase property rates to offset the fall in revenues.

Recommendation 2.6: That the Government increase efforts to assist the states and territories in achieving reform, including harmonisation of state and territory taxes.

2.7 Goods and Services Tax

2.7.1 GST Adjustment provisions

The GST adjustment provisions are intended to deal with changes in intended use (that is, changes in creditable purpose). GST registered entities are entitled to claim an input tax credit to the extent that an acquisition is made for a creditable purpose. If an acquisition was partly used for private purposes or input taxed activities, the extent of creditable purpose would be limited to the part used to make taxable or GST-free supplies only.

The GST provisions which deal with adjustments are contained in Divisions 129, 130, 131,132, 135 and 138. Most taxpayers fail to strictly comply with these provisions due to their complexity and inflexibility and they represent one of the most misunderstood aspects of the GST system.

Accordingly, a simpler mechanism which achieves the broad policy aim should be considered. Whilst the Institute recognises that the current adjustment system is theoretically more accurate, its complexity creates compliance difficulties. A simpler and more flexible mechanism is likely to achieve higher compliance. We would be prepared to consult with Government to consider various options to improve the provisions.

2.7.2 GST and the margin scheme

Division 75 of the GST Act sets out special rules for real property that allow taxpayers an alternative means of calculating GST. The policy intent behind the margin scheme is to ensure that GST is payable only on the incremental value added to land by each registered entity in a series of transactions after the land enters the GST system.

The policy objective of the margin scheme is to achieve three outcomes:

1. to exclude pre 1 July 2000 value from the taxable value of land;
2. to exclude post 1 July 2000 value added other than through a GST-registered enterprise from the tax base; and
3. to ensure that each supplier pays GST only on the value added by that supplier.

Unfortunately, the margin scheme currently fails to achieve policy objectives due to shortcomings in design. We acknowledge the significant challenges in a GST context in trying to devise a system that achieves policy objectives. This is due in part to the complexity that is common in property transactions as well as having to deal with conceptual differences between the legal definition of real property and its tangible attributes. The current margin scheme provisions result in complexity, uncertain outcomes and significant compliance costs.

We acknowledge that the margin scheme represents a departure from the basic rules of GST law and therefore involves an additional level of complexity such as the need to obtain valuations of real property or to identify that the vendor is eligible to sell using the margin scheme.

Unfortunately, tinkering with the margin scheme legislation; designed to protect its integrity and system design, has resulted in unintended consequences which undermine the original policy objectives.

Examples of unintended consequences include:

- Application of GST to value added since 1 July 2000 that was not in the course of a GST-registered enterprise.
- The application of GST on value added since the entity acquired the property and not on the value at the date of effect of its registration or the date on which the land was 'ventured' into an enterprise.
- Having to look back at the treatment of past transactions by external unrelated parties to determine eligibility to use the margin scheme can be extremely difficult to achieve. A system that requires tracing will inevitably create ongoing technical and practical application difficulties as well as costly compliance.

The retention of the current margin scheme design approach will not in our opinion alleviate the scheme's shortcomings.

The replacement of the margin scheme with a simpler, more efficient model better able to deal with many of the fundamental challenges is preferred.

There are alternative policy models for the GST treatment of property such as the notional input tax credit regime which warrants consideration.

We urge the Government to seriously consider reform in this area.

Recommendation 2.7.1: Recommend that the current GST adjustment provisions be replaced with simple arbitrary adjustment provisions.

Recommendation 2.7.2: That the margin scheme provisions should be replaced with a simpler and more streamlined alternative policy model that achieves broad policy aims.

3.0 Superannuation and Financial Services

3.1 Increase in annual concessional contributions cap

The Institute believes the current concessional contributions cap of $25,000 (or $35,000 for certain members) requires increasing. Particularly for those aged 50 or older who have finished paying off mortgages and supporting children, and who are now nearing retirement, it is important for legislation to assist those in this age group to increase their superannuation balances.

Accordingly, superannuation policy for those aged over 50 years should be based on providing capacity for additional contributions, while protecting against any abuse. Higher concessional caps would allow this group to make more adequate preparations for retirement in the final years of employment. The Institute believes the annual concessional contribution cap for those aged between 50 and 60 years should be raised to $50,000, and to $75,000 per annum for those aged over 60 years.

It is acknowledged there will be an immediate cost to government of increasing the concessional cap, and in this fiscally constrained environment this may be a bold suggestion. However, the lost revenue will be offset in future years in the following manner:

(a) Reduced cost of government aged pensions

According to the Australian Bureau of Statistics (ABS), the median superannuation balances of Australians aged between 55 and 64 is $90,000 for men and $60,000 for women. The average retirement age for men and women is 63 and 59 years respectively and the average life expectancy is 79 for men and 84 years for women. Based on current figures, the average retired couple will need to fund their retirement for around 16 to 20 years on just $11,500 per annum.

Moving forward, according to ABS statistics, the life expectancy for men and women in 2061 will be 92 and 97 respectively. Furthermore, whereas in 2012 approximately 15 per cent or 3.2 million Australians are aged 65 or over, in 2061 the ABS predicts this figure to be 31 per cent or 9 to 11 million Australians. Therefore, by 2061 not only will the number of Australians relying on the government pension triple, the number of years Australians will be reliant on government pensions will nearly double.

Policy designed to increase Australians' superannuation balances will therefore reduce the number of people reliant on government benefits in the future, thereby offsetting the short term loss in revenue that would result from increasing the concessional contributions caps.

(b) Replacing government spending on long term infrastructure with private funding

If more money is put into the superannuation system, the greater the possibility that large scale infrastructure projects can be funded by the private sector, thereby decreasing the amount of government spending. The increase in GST and taxation income generated from this increased spending, as mentioned previously, will offset the short term lost income arising from the increase in concessional contributions caps.

Recommendation 3.1: That the annual concessional contribution caps be amended as follows:

- ***For those aged 50 to 60 years: $50,000***
- ***For those aged over 60 years: $75,000***

3.2 Introduction of the Low Income Superannuation Contributions payment (LISC)

A result of recent taxation changes ensures that those earning less than the tax free threshold of $18,200 will now pay more tax inside super than outside. Furthermore, those earning between the tax free threshold and $37,000 will be taxed at just 19 per cent, only marginally better than the tax payable by their super fund. The incentive for this group to contribute extra into super is therefore diminished. Considering there are approximately 3.6 million Australians who fall into this income category, if policy is not developed to incentivise this group to contribute more superannuation, the number of Australians reliant on government assistance in retirement is likely to increase in future years.

Whilst increasing the concessional contributions caps will assist those in the middle to upper income categories, it is Australians in the lower to middle income groups that need assistance in providing for their retirement.

There are two particular government initiatives that currently exist, or are proposed, to provide assistance to this group of Australians. Firstly, there is the government co-contributions scheme which until the 2008-09 financial year provided up to $1,500 in assistance to low income earners making additional superannuation contributions. This amount has since been reduced to $500. The second initiative is the proposed low income superannuation contribution (LISC) payment of $500 which was linked to the MRRT, which the Government intends to repeal.

Whilst the Institute understands that from a policy perspective, the LISC is to be abandoned, from a fairness and equity point of view this policy should still be re-considered with alternative funding mechanisms,. . It is estimated that an additional contribution of $500 per year for someone currently aged 25 years is likely to lead to an increased superannuation balance at aged 65 of approximately $140,000, hence the reason the Institute believes in the importance of such a policy.

Recommendation 3.2: Reintroduce the Low Income Superannuation Contributions (LISC) to ensure low income earners are not disadvantaged by having their earnings directed to their superannuation funds

3.3 Remove the 10 per cent work test requirement for making concessional contributions

The Institute does not believe there to be any valid reason for the restriction on members making personal concessional contributions if the member earns more than 10 per cent of his or her income from employment services or any of the services listed in subdivision 290-C of the ITAA 1997.

It is felt this prohibition is inequitable for a number of Australians. For example, those who may have investments that provide passive income and also work part-time to supplement the passive income will be limited to the superannuation contributions made by their employer. To put this inequity into perspective, the maximum concessional superannuation contribution a part-time worker earning $15,000 from employment services who also owns an investment property valued at $350,000 producing a net return of $10,000 will be $15,000 if he or she salary sacrifices their entire employment income. However a worker earning $25,000 from employment services could make $25,000 worth of concessional contributions into his or her superannuation fund.

The Institute believes the source of the concessional contribution should not matter and that this particular item of legislation should be repealed. It is felt that Australians should be subject to a concessional contributions cap that does not discriminate against the source of the contribution.

Recommendation 3.3: Repeal legislation that prohibits a personal concessional member contribution where the member earns more than 10 per cent of their income from employment services.

3.4 Remove the work test for making contributions for those aged 65 or over

If the Government is serious about encouraging Australians to increase their superannuation balances, it seems counter productive to have legislation that prohibits anyone from making superannuation contributions after they turn 65 if they are no longer gainfully employed on at least a part-time basis.

The Institute sees no valid reason for such legislation and believes the legislation should be amended to allow Australians to contribute to their superannuation fund irrespective of whether they are gainfully employed and irrespective of their age. Changes to existing legislation should be considered that would allow Australians aged 65 or over and not working to contribute to super in situations that they are currently unable to do so. Some situations whereby those not gainfully employed may find themselves with money or assets to contribute to their fund include:

(a) when those aged over 65 sell their homes in the course of downsizing and may have additional money that could be contributed to superannuation;

(b) many aged 65 or over with assets such as property or other assets that provide insufficient income may liquidate such assets to invest in more liquid assets that produce a greater income stream needed for retirement;

(c) those aged 65 or over receiving passive income from investments may be in a position to contribute to superannuation; and

(d) where a widow or widower inherits money from his or her spouse’s estate upon his or her death.

Note the above is not an exhaustive list of examples whereby a member currently aged 65 or over and not working would benefit from a change in legislation.

Recommendation 3.4: Repeal the relevant legislation that prohibits contributions to a superannuation fund by Australians aged 65 or over if not gainfully employed on at least a part- time basis.

3.5 Encourage members to take benefits as a pension rather than lump sum

Whilst extensive legislation exists to regulate how much, and the manner in which Australians contribute to superannuation, limited legislation exists relating to how Australians withdraw their superannuation once they have retired or reached 65 years of age. Accordingly, Australians are free to do as they please with their superannuation upon meeting certain conditions of release. ABS data from 2007 shows around 60 per cent of retirees take either a partial or total lump sum. Of this group only 40 per cent invested in a pension product (an annuity or life pension) or an income earning product (bank account). Around a third of all retirees used the lump sum to pay off a mortgage, while 16 per cent of males purchased a new car.

It is the Institute’s view that the use of retirement funds in this manner is not always appropriate and does little to diminish the future pension burden faced by a shrinking workforce and aging population.

The Institute supports choice in superannuation decision making, but also believes there needs to be suitable incentives which encourage retirees to invest in income streams such as pension and annuity products. Annuities will generally better provide for the longer term needs of retirees and protect against cost of living risks. Annuities are also clearly more closely aligned with the policy intentions of the superannuation system.

Consistent with the findings and reform proposals of the Henry Review, the Institute recommends amendments to taxation and superannuation laws to encourage the development and uptake of annuity products, but not to make it compulsory.

The institute also recommends the age threshold of 60, whereby any lump sum withdrawn by those aged less than 60 is tax free up to a cap, which is currently $180,000, be removed. In other words, any lump sum in excess of a member's life time low rate cap, irrespective of their age, will be taxed at the same rate as anyone under age 60 which is currently 16.5 per cent.

As those taking a transition to retirement income stream (TRIS) are subject to maximum draw down amounts, the Institute believes legislation should be introduced to apply a maximum draw down amount to all pensions, with any excess withdrawals taxed at 16.5 per cent. As there is currently no limit on how much can be withdrawn by those receiving a pension, in the absence of a maximum pension drawdown, any legislation to tax lump sums in excess of a low rate cap could be circumvented with members withdrawing the entire superannuation balance as a pension.

Recommendation 3.5: That the recommendations in the Henry Review in relation to annuity and deferred annuity products be adopted to encourage the use of annuity and other life pension products upon retirement. A post-retirement products review should also encompass taxation arrangements for lump sum payments and the development of annuity type products

3.6 Removal of the requirement for a bare trust for acquisitions using a limited recourse borrowing arrangement (LRBA)

One of the key considerations when a superannuation fund borrows to acquire a single acquirable asset (SAA) under a LRBA is that the lender does not have recourse to the other assets of the superannuation fund. This, along with the desire to be in line with instalment warrant arrangements that the larger superannuation funds traditionally invested in was the reason for borrowing legislation to include the requirement to hold the SAA in a bare trust.

Not only does the Institute believe a bare trust to be unnecessary, it also believes that the requirement for a bare trust under these arrangements creates complexity and significant costs and therefore legislation should be amended to remove this requirement. Provided the loan documentation prohibits recourse of the lender to the SAA acquired under a LRBA, the objective of protecting the fund's other assets can still be achieved with significantly less complexity and cost.

Support for this recommendation can be found in the fact that since legislation was passed to allow such borrowing arrangements, the ATO has been required to issue a number of publications and pronouncements to clarify the Commissioner's position on the application of the LRBA legislation. Additionally, one only needs to speak with a variety of SMSF lawyers who will all highlight how technically complex this legislation is with many providing a different opinion on the application of the LRBA legislation.

Recommendation 3.6: That legislation relating to LRBAs be amended to remove the requirement for the single acquirable asset to be held on trust so the superannuation fund trustee obtains a beneficial interest.

3.7 Small business superannuation compliance

Small business, as with large business, has a plethora of reporting obligations. However, unlike large business which is usually better resourced to deal with the multitude of reporting requirements, the cost of compliance for small business is disproportionately higher.

The Institute therefore welcomes the Government's commitment to reduce the compliance burden on small business. As it relates to superannuation payments on behalf of employees, the Institute believes that small business compliance costs will be reduced if they no longer administer superannuation payments on behalf of employees. And whilst it commends the introduction of the small business superannuation clearing house, the Institute believes this could be further enhanced to benefit small business through the following recommendations.

Firstly, whilst acknowledging the efforts of the Department of Human Services, the Institute believes the ATO is the more logical department to handle superannuation payments made via the small business superannuation clearing house as superannuation payments align more closely with the ATO.

Secondly, we feel the threshold of 19 staff to be eligible to use the clearing house should be increased to 100 staff to help more businesses reduce their compliance costs.

And finally, the Institute believes that a single payment to the ATO on behalf of employees, comprising income tax and the superannuation contribution would ensure that employee's Superannuation Guarantee (SG) is paid in a timely manner. We believe one option to achieve this objective would be to have the SG payment made with and attached to the quarterly Business Activity Statement.

Recommendation 3.7: The small business superannuation clearing house should be brought under the jurisdiction of the ATO as proposed by the government.

Recommendation 3.7.1: The threshold with regard to staff numbers eligible to use the small business superannuation clearing house should be increased from 19 to 100.

Recommendation 3.7.2: Another reporting option should be incorporated into the quarterly BAS to allow superannuation payments to be made to the ATO for it to pay into members' superannuation funds.

4.0 Other matters

4.1 Standard Business Reporting

The Institute is a strong supporter of the Government's initiative to streamline reporting and lodgement using Standard Business Reporting (SBR). SBR and its integrated approach to the lodgement of information with government departments, regulators and government agencies is gradually being adopted by accountants and their clients.

Greater awareness is still required and despite efforts by Treasury, government and stakeholders such as the Institute, it is obvious that much more needs to be done to raise awareness among businesses, accountants and the public.

The Institute continues to encourage members to be proactive and use SBR enabled software and SBR technology. We also encourage awareness raising with clients of the benefits of SBR.

Institute members have indicated they are prepared to move to SBR if their chosen software vendor provides SBR enabled software. We believe the lack of SBR enabled software, to date, has hindered the rate of adoption. This is expected to change as more SBR enabled software is released by the major providers.

Internationally, more countries are adopting SBR/XBRL including the adoption of a SBR/XBRL taxonomy in International Financial Reporting Standards. The International Federation of Accountants is a strong supporter of SBR/XBRL and has released a joint report: *Leveraging XBRL for Value in Organizations* which promotes the benefits of SBR/XBRL.

The Institute strongly urges the Government to maintain adequate funding for the SBR initiative in order to realize its significant benefits to the economy including small business.

Recommendation 4.1: That the Government maintains funding for the SBR program to ensure benefits are realised.

Contact

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