cutting through complexity

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# Re:think(ing) the Australian tax system: A New Zealand view

Lower, simpler, fairer: the focus is on building a better tax system for the 21st Century and Australia's place in it.

The end result will affect New Zealand's tax system and economy.

While its cricket team was busy winning the World Cup, the Australian Government has embarked on a much harder task – reforming its tax system. It has released a discussion document, *Re:think*, asking for ideas to bring Australia's tax system into the 21st century.

Is there a lower, simpler, fairer, way to tax? This question was considered in New Zealand by the 2010 Tax Working Group. The Tax Working Group experts did a top to bottom review.

The Australian process is very much at the scoping stage, setting out the current system and its challenges. It poses 66 questions to address those challenges. The solutions are expected to be the current Australian Government's tax policy for the next Federal election.

Some of the identified challenges with Australia's current tax system include:

- Over-reliance on company and personal tax, which is likely to be unsustainable.
- Tax "bracket creep" from wage growth (meaning higher marginal rates of tax apply) while, due to an ageing population, fewer working age people will pay tax.
- The need for a competitive corporate tax regime to encourage investment.
- The rise of the digital economy and what this means for the tax system's effectiveness.
- The effectiveness of Australia's tax administration and the sustainability of revenue sharing arrangements between the Australian States.

The end objective is a better tax system that delivers taxes that are lower, simpler and fairer. You can read KPMG's Australia's commentary here.

## *Isn't it bad enough they won the World Cup, why is this relevant for New Zealand?*

Changes to the Australian tax system matter. Australia is New Zealand's largest trading and investment partner. Any major changes to Australia's tax policy settings and administration will impact New Zealand businesses that operate in Australia, investment into and from Australia, and the competitiveness of New Zealand's own tax system.

The discussion document sets the scene, so there is no immediate impact. However, it is possible to read between the lines for some hints on possible direction of reform. It is also worthwhile testing New Zealand's system with the background that the discussion document provides. Taxmail considers some of the key issues raised in the discussion document through this lens.

### *The future direction of Australia's company and imputation tax system*

Like New Zealand, company tax plays a significant role in the Australian tax mix. There are concerns the current rate may not be competitive. Any reduction in the Australian company rate will put pressure on the New Zealand rate. The discussion document suggests the possible removal of existing industry and specific tax concessions to fund a rate cut. This is less feasible in New Zealand, as there are few tax incentives and concessions to remove. This suggests an alternative tax base or other rate changes may be required to fund a company tax rate reduction here.

Imputation removes double taxation for Australian shareholders. There is concern that this may adversely impact savings decisions, by incentivising investment in Australian companies over foreign companies. The document discusses the merits of other company and shareholder tax models for Australia. Australia shifting away from imputation would raise serious questions about its future in New Zealand.

One of the questions is whether Australia would benefit from mutual recognition of imputation credits with New Zealand. The discussion document notes it could improve the allocation of investment between Australia and New Zealand, but also raises compliance, administrative and fiscal cost concerns from doing so. This suggests to us that even if Australia retains its imputation system, its agreement to mutual recognition will be elusive. This is however one area where New Zealand business can and should consider joining the Australian conversation.

*A single tax treatment for savings?*

The different tax treatments for Australian savings – i.e. interest taxed at full marginal tax rates, dividends at marginal rates after imputation credits, capital gains on shares discounted by 50%, superannuation savings at 15%, investment property returns at various rates, and the family home untaxed – is raised as a concern. The question posed is whether this distorts investment decisions (although there is no hint of changing the tax treatment of the Australian family home).

New Zealand, in contrast, does not offer concessionary tax rates on savings (the lack of a general capital gains tax and tax rates for Portfolio Investment Entities being exceptions). The 2011 Savings Working Group undertook a review of our savings tax regime, as part of a wider review of New Zealand's medium-term savings strategy. Its recommendations, including that there may be merit in concessional savings tax rates in some circumstances, have yet to find favour.

*A holistic view of the tax burden*

One of the themes of the discussion document is fairness needs to be judged by considering the effect of all taxes and transfers (i.e. the net "tax burden"). We are unable to make that judgement for Australia but a holistic view of the effect of tax and transfers is required for New Zealand.

It is artificial to separate the taxation of personal income from savings and superannuation, business income and consumption. Although not everyone runs a business, those that don't will generally have employment income. Most will also have some savings income (e.g. bank account interest, KiwiSaver earnings or rental from property investments). And everyone spends so GST also applies. On the other side of the ledger, families may receive Government assistance, such as *Working for Families* tax credits, and other benefits. Adding all of this up provides a much better view of the tax burden, and who bears it, than a simple comparison of any one aspect of the tax or transfer system.

*GST applies to everything, doesn't it?*

GST is currently not being collected on low value imports (imports less than A$1,000 in Australia and NZ$400 in NZ) and digital services. The discussion document suggests this will affect the competitiveness of Australian business over time. It also notes that other developed countries have relatively low thresholds compared to Australia, suggesting that a cost-effective reduction in the low value threshold could be feasible. However, a solution in Australia seems some way off as changes to GST are somewhat more difficult. This has wider implications for any changes to the Australian GST system.

For example, there is recognition that Australia's GST base is not as wide as it could be. New Zealand is held up as the model for an efficient and simple GST system. A broader Australian GST base might make it feasible to fund other tax changes, including company and personal tax cuts – i.e. a similar income tax to GST switch to that in 2010 in New Zealand. However, as the GST is for the benefit of the States, the Australian Government has indicated that no changes will be made without the agreement of the Australian States. This may narrow the range of possible reform options.

*Reinventing the ATO (and Inland Revenue)*

It is not just Inland Revenue that is undergoing a business transformation. The Australian Tax Office (ATO) is also embarking on reform aimed at improving the "client experience". The message from both Governments is clear – tax authorities need to do more with less. A key focus therefore is leveraging technology. This includes greater use of digital solutions for both taxpayer assessment and risk profiling purposes. (Taxmail comments separately on the recent New Zealand green paper on *Making Tax Simpler*.)

*They do things differently over there*

As the 100th anniversary of the ANZAC landings at Gallipoli approaches and we reflect on the many things we have in common, the discussion document illustrates again that the Australian political and economic context is different. Matters which New Zealanders might consider relatively straight forward to address are significantly more difficult in a Federal system.

The starting point, the process and the end points are likely to be different. They will impact on New Zealand. The open question is whether the solutions will be positive but the opportunity should be taken to engage.

## *Further information*

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