1 June 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES, ACT 2600

Email: bettertax@treasury.gov.au

Dear Treasury,

AFA Submission – Tax Discussion Paper

The Association of Financial Advisers Limited ("**AFA**") has served the financial advice industry for over 65 years. Our aim is to achieve *Great Advice for More* Australians and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Thank you for the opportunity to provide a submission in response to the Tax discussion paper.

Our goal at the AFA is to achieve Great Advice for More Australians. Consideration of tax is a critical component of financial advice and we are therefore particularly interested with this matter and the issues raised.

We fully support the stated objective of a "*better tax system that delivers taxes that are lower, simpler, fairer."*

In this submission we have focussed upon tax matters related to retail clients, with a particular focus upon matters related to taxation on savings. We have also addressed a number of other issues.

We are very conscious that the trade-off between simplicity and fairness possess significant issues. In addition we recognise that there are significant structural issues that are not easy to address. Further it is very problematic to make wholesale changes as this always leaves winners and losers and there is very limited political appetite to make changes that will leave certain groups disadvantaged. In summary our key observations on the Australian tax system are as follows:

- The Australian taxation system has a high reliance upon personal income tax.
- The Australian company tax rate has become internationally uncompetitive
- The lack of balance between the taxes raised by the states and the expenditure at a state level, remains an important issue to resolve.
- Stability of the system is important to ensure that Australians remain confident in their decision making and can develop and continue to implement their financial plans.

There is one obvious solution that will enable the Government to address the issues raised above, which involves a broadening of the base and/or a potential lifting of the GST rate. Such an action would allow a reduction in personal and company income tax rates, and facilitate a better balance across the Commonwealth and the states.

For a society and an economy to excel there needs to be adequate incentive. The world is also going through a period of fundamental change, which highlights the need for flexibility and adaptability. More needs to be done to ensure that workers and small business have sufficient incentive to have a real go. Ensuring the trade-off between the tax system and the welfare system is critical to getting the best possible level of workforce participation. This is extremely complex, however the contribution to the economy is substantial.

Efficiency is an important element of the tax system, with a need for a review of those taxes that raise little revenue and to address areas where standardisation and simplification would significantly reduce cost and net return. As an example, the payroll tax arrangements (including rates) and stamp duties vary across the states, making the need for multiple processes and activities, which all drives increased compliance costs.

We talk further below about our direct concern with respect to how payroll tax is impacting upon financial advice small businesses.

1. – Can we address the challenges that our tax system faces by refining our current tax system? Alternatively, is more fundamental change required, and what might this look like?

There are many complex parts to a taxation system that exist at many different levels. Change does not exist solely at two distinct ends of a continuum (incremental and fundamental). The eventual package of reform will likely involve many parts, some of which might be incremental and others may be more fundamental.

3. – How important is it to reform taxes to boost economic growth? What trade-offs needs to be considered?

International comparisons suggest that getting the right balance in the taxation system has substantial impact upon the overall effectiveness of an economy. An ineffective taxation system that leads to high levels of tax avoidance and potentially corruption, can have a hugely negative impact upon a countries' economy. As stated above, the tax system needs to be based upon the right balance that delivers appropriate incentives for growth at both an individual and a corporate level.

4. – To what extent should reducing complexity be a priority for tax reform?

In our view reducing complexity is a critical part of this review. Removing complexity, on its own cannot be the objective if this leads to a range of unintended and negative consequences. The focus upon removing complexity should be in those areas where there is significant gain and the downside risk is acceptable. Where complexity exists it should be justifiable on a cost benefit basis.

5. – What parts of the tax system are most important for maintaining fairness in the tax system? Are there areas where fairness in the tax system could be improved?

The tax system needs to be viewed in its broad context as an overall system, rather than at specific elements or measures. As an example often commentators look at the advantages of the superannuation contributions tax measure for high income earners, noting that this provides greater advantage for them than it does less highly paid people making contributions into super. This assessment fails to take into account that high income people are much less likely to receive the age pension in later life, which means that it is necessary to look at the equity of the superannuation contributions tax arrangements in a broader context, which includes consideration of the age pension.

Particular tax initiatives can also create unfairness at certain income points. As an example the additional 15% contributions tax applied to higher income earners above $300,000 (Division 293 definition that includes concessional super contributions, FBT, investment losses etc.) creates a very high marginal tax rate for a particular group. A person at the Division 293 threshold of $300,000 will pay 64 cents in tax on their next dollar of income (49 cents in income tax and 15 cents extra contributions tax, which can either be paid directly by the employee or from the super fund). This marginal tax rate will then return back to 49% once they have reached the point where their income (as defined by Division 293) exceeds $300,000 plus their concessional superannuation contributions.

6. – What should our individuals income tax system look like and why?

It is absolutely accepted that the system needs to be progressive, which is exactly what it is. The big issues with the individual income tax system are to ensure that the marginal tax rates don't unacceptably reduce incentive and also to ensure that bracket creep is effectively managed. It is our view that automatically indexing tax brackets would remove an important lever for the Government. The way it currently works the Government can choose to make changes, in the areas where they believe it would be most effective and at a time that the overall budget can support.

7. – What should our fringe benefits tax system look like and why?

In large part the fringe benefits tax system is a tax avoidance measure. We note that there are certain exemptions and beneficial treatment regimes that make the utilisation of FBT appropriate in certain context. Predominantly this covers FBT on cars, and the special exemptions that apply to charities and other eligible entities that has been designed to provide remuneration incentives for the employees of such entities. Other than for cars and for those charitable and related entities that have preferential treatment, to some extent, the FBT system would be working best when no employees are actually utilising fringe benefits.

8. – At what levels of income is it most important to deliver tax cuts and why?

Clearly the Australian budget has little capacity to support tax cuts at this point. When that position does arrive it is most likely that tax cuts will be most effective when directed to middle income earners. This is likely to be via a measure designed to address bracket creep. As stated above, fundamental change to the GST might enable greater and quicker change to the individual tax system.

9. – To what extent does taxation affect people's workforce participation decisions?

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10. – To what extent are the interactions between the tax and transfer systems straightforward for the people who deal with both systems?

We will address these questions together. The combination of the tax system and the transfer or welfare system has an important impact upon the workforce participation rate. It is the marginal tax rate that is most critical, however, it is often the case that without tax or financial advice, people do not understand the implications of returning to work or increasing/reducing work hours. Thus the system can be tweaked to ensure that the transition from not working to working again can be as beneficial as possible, yet this is not well understood by those impacted by it.

11. – How important is tax as a factor influencing people's decisions to work in other countries?

Tax will often be a factor in such a decision, however it is unlikely to be the dominant factor. An internationally competitive tax system is important to avoid an excessive level of highly talented and mobile people from leaving Australia to work overseas. This is another important factor to take into account.

12. – To what extent is tax planning a problem in the individuals income tax system? Are existing integrity measure appropriate?

Careful planning of taxation within the context of the existing laws should not be discouraged. It is tax avoidance that should be the focus of legislative and enforcement action. We would not like to see any measures introduced that would limit an individual's capacity to effectively prepare and plan for tax, particularly as they approach retirement. The integrity measures inevitably need to be dynamic and be modified over time as new risks emerge. We do not believe that there are huge risks to the integrity of the system at this point in time.

15. – To what extent do our arrangements for work related expense deductions strike the right balance between simplicity and fairness? What could be done to improve this?

We are conscious of recent discussion and consideration in previous budgets of access to a standard work deduction, that employees could elect to take. We also acknowledge that this is likely to have a net negative impact upon tax revenue and the budget with the automatic deduction being adopted by many employees who may never have made a claim. This introduces a level of inequity in the system in that these people would be gaining the same benefit as those who are legitimately entitled. There is merit to further investigation of ways and means of automating the work related deduction section of the tax return, however with all issues in the tax system, there is a trade-off and it is the seeking of the right balance that should be the primary focus.

17. – To what extent are the concessions and exemptions in the fringe benefits tax system appropriate?

Concessions and exemptions in the fringe benefits system have been progressively reduced and simplified over time. In our view this is appropriate, so that what is left is large consistent with the broader objectives of the tax system.

18. – What tax arrangements should apply to bank accounts and debt instruments held by individuals?

We recognise that the current arrangements for tax on interest bearing deposits provides no protection from inflation, which is inconsistent with the treatment for capital growth investments. Whilst this might leave an option available for modification to address this, we also consider that such a change may risk exposure to other unintended consequences. Whilst we acknowledge the issue, we believe that it is more appropriate to focus tax incentives on the parts of the economy that contribute most to overall growth.

19. – To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?

When CGT was introduced in 1985, it was designed to provide protection from inflation through the indexing of the cost base. In September 1999 this was changed to a simpler model where the impact of inflation was addressed by effectively assuming that 50% of the increase in the value of the asset was inflation and the remainder was a taxable capital gain. It is likely that over some time periods and with some assets this might be an overestimate and in other cases an underestimate. This will depend upon the underlying inflation rate and the rate of growth of investment assets. We continue to believe that the simplicity of the current model is justification for continued support for it. It is important to encourage savings and investment and the CGT discount achieves this objective.

20. – To what extent does the dividend imputation system impact savings decisions?

Dividend imputation was introduced as a means of avoiding double taxation. It has achieved this objective and it is now an integral part of the Australian taxation system. Whilst we do not believe that the existence of the dividend imputation system has a great impact upon the selection of equity investments in aggregate, it does have an impact in terms of the allocation between domestic and global equities. This is likely to have a much greater impact outside of superannuation as opposed to inside superannuation where the tax rate is lower. The asset allocation across domestic equities and international equities is an important consideration to focus on, however it would not be sufficient justification to change the dividend imputation system. Consumer education and financial literacy need to play a role in increasing the level of understanding of the importance of diversification. It should also be noted that any future reduction in the corporate tax rate, which is important from an international competitiveness perspective will reduce the impact of the dividend imputation system.

21. – How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

As discussed above under question 5, we are aware of the debate with respect to the taxation of superannuation. We acknowledge the tax advantage for higher income earnings in investing in superannuation. Nonetheless, we believe that incentives for investing in superannuation that provides for income in retirement should be encouraged across all income levels. We also consider that this issue should be viewed across a broader spectrum, where consideration of access to the age pension is also considered.

The current arrangements with respect to concessional contributions to superannuation have particular controls built in that include the following:

- A cap on concessional contributions of $30,000 (or $35,000 for those aged 50 or older).
- A cap on non-concessional contributions (six times the concessional contribution cap).
- An increased tax for those with “grossed up” income of over $300,000.

The impact of this is that it places limitations on the size of superannuation accounts and the tax benefit being achieved via superannuation contributions.

We acknowledge that there are some very high superannuation account balances and that these people are achieving a disproportionate benefit in terms of the taxation on the earnings of superannuation funds. This issue has become even more of a factor when considered in the context of the pension phase, where no tax is applied. We recognise that this is an issue that has been considered by the former Government and that there have been recent proposals with respect to an additional tax on either higher pension account balances or higher pension income earners. All of these options involve significant complexity where the cost to implement and the risk of unintentionally impacting those who were never the target, make this particularly difficult. We would support consideration of a review of the viable options for introducing an additional taxation liability for accounts above a certain high level trigger point.

With respect to any changes to the superannuation system it is essential that the changes do not damage confidence in the overall system. The numerous changes over time have caused an inevitable negative impact upon consumer confidence to invest, which is unhealthy for individuals and the country as a whole. Stability in the superannuation system needs to be a priority.

23. – What other ways to improve the taxation of domestic savings should be considered? How could they be applied in the Australian context?

On reflection Australia has a world leading superannuation or pension system and has a very vibrant financial services industry. This all speaks well of a strong environment for a domestic savings system and a tax system that is largely effective at promoting domestic savings which is so important for investment and economic prosperity.

24. – How important is Australia's corporate tax rate in attracting foreign investment? How should Australia respond to the global trend of reduced corporate tax rates?

Australia has a long history of being dependent upon the flow of foreign sources of investment. This reliance is expected to continue, so it is therefore important that the Australian Corporate Tax rate remains competitive, particularly when compared to other countries which might be considered to be direct alternative investment destinations. The international trend in reduced corporate tax rates might be expected to continue, which would further increase the need for action. It is also noted that a reduction in the Corporate Tax rate would reduce the incentive for profit shifting and tax avoidance. The benefits of a reduction in the corporate tax rate are well articulated. The costs are likely to be partially mitigated by a combination of additional investment and the operation of the dividend imputation system. A reduction in the corporate tax rate should be a Government priority.

25. – Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?

A comparison with other jurisdictions highlights that many other countries use some mechanism to remove or reduce the impact of double taxation. It is likely that there would be significant costs involved in the transition to an alternative model, which is unlikely to deliver sufficient benefits to offset the costs, particularly when the actually tax collected is unlikely to vary greatly. We do not consider this area to be a priority for tax reform.

The ability to obtain a refund of franking credits is recognised as an outcome of this system that generates some concern. This does provide an equity measure for those on lower tax rates who have invested in shares, however it is appreciated that it might be used for aggressive tax planning purposes by the owners of closely held companies. Consideration should be given to mechanisms to avoid such practices.

Business Taxation System

As a professional association for financial advisers who predominantly work with retail clients, we have prioritised our focus on issues more directly related to the individual tax system. We have therefore not provided feedback with respect to the business tax system related discussion questions.

Other Important Issues

Payroll Tax

In the last few years a number of cases have emerged where state revenue offices have sought to obtain payroll tax from financial advice licensees who operate a self-employed business model. The licensee authorises these advisers to provide advice to clients, in a model where the adviser owns their own business, but seeks to be authorised by the licensee rather than needing to obtain their own license. The advisers run their own businesses and provide advice to clients on a range of different investment products. The interpretation of some states is that if the adviser has less than 2 employees then they are seeking to treat the adviser as an employee of the licensee and apply a payroll tax liability. This is despite the fact that any payments from the licensee to the adviser are subject to GST. This issue is having a destabilising influence on the financial advice industry, particularly where they are talking in terms of back dating these assessments. This would have huge financial implications for those licensees who are not institutionally owned and might even lead to some business collapses. We ask the government to address this issue as part of this review process.

We also believe that Payroll tax serves as a disincentive for the employment of staff. It is a significant additional cost involved in the employment of people. The current low thresholds mean that many businesses are captured by this system when they are really only small business. This directly inhibits their capacity to grow. In our opinion Payroll tax should be prioritised for improvement with the thresholds significantly increased and better standardised across the states. It would also significantly add to efficiency for those companies that operate in multiple states to have one collection mechanism.

Conclusion

We thank you for the opportunity to provide feedback on the Tax discussion paper. Ensuring an effective taxation system that provides appropriate incentive and encourages investment is essential for the future success of Australia. This is an important review and we welcome the opportunity to provide further input.

Should you have any questions, please do not hesitate to contact me on 02 - 9267 4003.

Yours sincerely,

Phil Anderson

Chief Operating Officer