



Talking about a tax revolution

Tony Harrington of PwC finds out from Federal Treasurer Peter Costello about Australia's plans to dramatically shake up its outdated tax systems.

Harrington: You stated that your tax reforms "would produce a world-competitive taxation system and what that means is investment and jobs". This is obviously good news for the CEOs of Australia's multinational corporations. In a global economy where countries like Ireland have reduced their corporate tax rates to 10%, and our new reduced capital gains tax (CGT) rates are still higher than those of the US and Japan, how exactly do you believe your tax reforms will enhance Australia's international competitiveness?

Costello: A major boost to Australia's international competitiveness from the business tax reforms will come from the lowering of the company tax rate to 30% by 2001-02. The reduction in the company tax rate will bring Australia's rate more into line with the rates of other countries in the Asia-Pacific region. This will increase Australia's attractiveness as an investment location, strengthening Australia's prospects for investment, economic growth and job creation.

The new CGT measures will enliven and invigorate asset management, stimulate greater participation by individuals in investment and contribute to a better allocation of the nation's



Peter Costello

tle, too late and the government has missed the big issue. This package does not offer investors much."

Costello: We are witnessing a generational change to the Australian tax system. The changes include: major cuts in personal income taxes; increased assistance for families; the simplifying and streamlining of the indirect tax system with the introduction of the goods and services tax (GST); reductions in fuel costs; the lifting of the indirect tax burden on exporters; and a landmark change in Australia's Commonwealth State financial relations.

We are in the process of implementing historic structural changes to the Australian taxation system. In terms of business tax reform, companies were extensively consulted throughout the

Ralph Review [*The review of Australian business taxation, 'A Tax System Redesigned' July 1999*] and this has contributed to widespread business support for the government's announced changes.

Reducing our company tax rate to 30%, and the maximum rate payable by individuals on capital gains to 24.25% (and even less for smaller businesses) will significantly boost

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capital resources. The new CGT measures will make the rate of CGT in Australia for individuals competitive with those in other countries, particularly the US.

The government's broad-ranging reforms to Australia's antiquated indirect tax system will also boost our international competitiveness. The government has legislated significant personal income tax cuts, such that from 1 July 2000, 80% of Australians will have a marginal tax rate of 30% or less.

Harrington: What do you say in response to comments by Australian CEOs such as Peter Carre, Managing Director of Wilshire Global Advisers, who says: "These reforms are too lit-

investment and job creation.

Other aspects of the package also simplify the tax system and reduce taxpayer compliance costs.

Growth in small business will be encouraged through the expansion and simplification of the small business CGT rollover relief provisions. Compliance costs will be reduced for small businesses through the Simplified Tax System, which will also effectively maintain their access to existing concessions such as accelerated depreciation. Buttressed by a range of integrity measures to improve confidence in the system, we have delivered a modern, competitive and fair business tax system. And this has been done without jeopardising the hard-

won budget surplus the business community was so keen for us to achieve in the first place.

Harrington: Your original brief to the Ralph Review required the reform measures to be revenue neutral. Given current favourable economic circumstances and forecasts that are contributing to the increasing government surplus, do you have plans to move away from revenue neutrality to deliver further corporate and individual tax cuts?

Costello: The government has legislated a number of significant changes to reduce income tax rates, increase payments to families and increase pensions and allowances, as part of its New Tax System.

These measures include about \$12bn-worth of tax cuts a year; roughly \$2.5bn a year in increased assistance to families; more than \$2.5bn a year in increased support payments; and \$1.5bn to senior Australians in the form of one-off bonuses.

In terms of business tax reforms, the revenue neutrality requirement was a feature from the outset.

The Review of Business Taxation made recommendations on this basis and the government is committed to legislating on this basis.

Combined, the government's taxation reforms will dramatically improve Australia's tax system and enhance incentives to work, save and invest.

of profits and the tax treatment of assets". What benefits can you identify for business from this move, and how will these benefits offset the dramatic upheaval this move will cause?

Costello: The government sees merit in the potential of the cashflow/tax value approach to provide Australia with a more durable tax system into the future and has given it in-principle support. It has established a working group of officials and representatives from the business community to progress the practical implementation of the new approach. Dick Warburton, Chairman of the Business Coalition for Tax Reform, is leading the business representation in these consultations.

The cashflow/tax value approach is a new framework for the income tax laws. It will not change existing tax law outcomes, but will provide a clearer and simpler law. It will replace the current patchwork of laws, which are built on outdated legal concepts, with a tax law that better reflects commercial reality. This will give us a simpler, shorter and more certain tax law. Once established, it will significantly lower compliance costs for taxpayers. Furthermore, it will provide greater integrity to the tax law that will facilitate increased compliance.

Harrington: There is an increasing trend by the government to issue press releases heralding tax changes, with draft legislation following many months after. Do you plan to

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Harrington: Your move to halve the top CGT rate for individuals appears to be a boon for investors. However, the removal of indexation means investors will end up paying more CGT for longer-term investment. How do you respond to suggestions that this is a case of 'one step forward, one-and-a-half steps back' for Australia's CGT regime?

Costello: The government believes that the reforms to CGT will provide substantial benefits to the Australian economy and to individual taxpayers. Investors will face lower compliance costs as a result of the removal of the complexity of averaging and indexation. The 50% discount, together with the income tax cuts already legislated, will mean that for 80% of Australians the rate of CGT will be 15.75% or lower.

Smaller businesses will also benefit from simplified and expanded CGT rollover relief and retirement exemptions. Individuals owning small firms will be liable to pay tax on a maximum of 25% of a capital gain on the sale of active small business assets. Where the taxpayer invests in new active assets, the liability can be deferred through the rollover provisions. Where the proceeds of the sale are used to fund retirement, there is a CGT exemption.

Harrington: You have broadly endorsed a revolutionary move towards cashflow-based accounting, which would radically reduce the scope for tax minimisation and planning. According to commentators, this means that "ironically, accounting regulators will now take on even more importance because their decisions will affect both accounting treatment

streamline this process to relieve business of lengthy periods of uncertainty?

Costello: Policy decisions are announced quickly to provide certainty, and the legislation follows as soon as is possible in a democratic system to give effect to those decisions. The government's general approach following the Ralph Report is to introduce legislation well before the commencement of particular provisions.

In the case of business tax reform, extensive consultation with business has contributed to the reforms being widely accepted. Further consultation is also occurring on settling the implementation details of the government's business tax reforms before legislation is introduced.

Harrington: The advantages of using respected business leaders in the tax reform consultation process are self-evident. What plans does the government have for the future, ongoing involvement of business leaders in the formulation of tax policy?

Costello: The government is committed to consultation with business as a means to developing better tax policy and legislative outcomes. As you know, we have invited Dick Warburton to lead business representation in exploring implementation issues associated with Option 2 (the cashflow/tax value method of calculating taxable income). The government will also establish an Advisory Board of Taxation to act as a high-level source of business sector advice to the government

on aspects of tax policy, legislation and administration. (The members of the board have since been appointed.)

Harrington: There have been reports that research and development levels have been dropping off in Australia. Tax concessions for research and development were 150% under the Labour government, with tax rates of 36%. This concession was reduced to 125% and your government is proposing a 30% tax rate.

Are there plans to restore the effective concession to encourage active participation in research and development?

Costello: The government's business tax reforms will boost investment in innovative projects. For example, there are incentives for greater investment in venture capital projects, through CGT exemptions for gains made by Australian super-annuation funds through Pooled Development Funds and by non-resident, tax-exempt pension funds, such as UK and US pension funds. Scrip-for-scrip rollover relief will also ensure that CGT liabilities do not inhibit the growth of emerging enterprises. Lower company tax rates and CGT rates will also contribute to encouraging investment and job growth in emerging industries.

Harrington: E-business is in the process of revolutionising the global business world. With the value of business done via the web expected to top US\$1.3bn by 2003, there is significant debate on how traditional tax rules will deal with the new electronic economy. Current rules would seem to favour countries such as the US. How has your business tax reform programme addressed this key issue for the Australian economy?

Costello: Australia is well placed to harness the opportunities arising from information industries and the information economy, to the benefit of all Australians – more jobs, higher economic growth and new markets for small businesses.

The growth of electronic commerce will impact on all the various economies and in many different ways.

In view of this, the OECD is preparing a framework for government responses to electronic commerce, including the

tax area, and Australia is actively contributing to this process.

Harrington: What words of encouragement would you offer Australia's CEOs in this time of dramatic change in the Australian tax regime?

Costello: As a result of the government's reforms, Australia will have a tax system that meets the needs of the new millennium, a system with more incentive, more integrity and lower compliance costs, a system with low rates and a broad base that makes Australia internationally competitive.

Through the Review of Business Tax consultations, business has contributed significantly to Australia's New Business Tax System.

John Ralph, AO, Rick Allert and Bob Joss were instrumental in this consultation and I would like to take this opportunity to record the government's appreciation to the many CEOs who agreed to their executives also participating in that consultation process.

Harrington: What is your vision for the Australian tax system of the 21st century?

Costello: A tax system suited to the 21st century is one that will create an environment for higher economic growth, more jobs and improved saving, as well as providing a sustainable revenue base so that the government can continue to deliver important services to the community.

The government's broad-ranging reforms to indirect taxation, personal taxation and now business taxation will deliver such a tax system – one with lower compliance costs and one which is modern, internationally competitive and fair. ■

Tony Harrington is PricewaterhouseCoopers' Country Senior Partner in Australia.

Peter Costello, MP, is Treasurer of the Commonwealth of Australia. He is Deputy leader of the Liberal Party of Australia.

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Michael Henigan, Managing Editor on +44 20 7213 0723

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