# *Terms of Reference*

## Business Income Tax Review

Business taxation is concerned with taxing investments in physical and financial assets (and their financing) and the collective vehicles or 'entities' through which these investments can be made.

## Objectives

The Review will pursue the strategy specified in *A New Tax System* of consultation on the framework of reform of **business entities** and on the extent of reform of **business investments** recognising the current problems and objectives for business tax reform identified in *A New Tax System*. The process of consultation will include an assessment of the design and the administration of the tax regimes affecting business to identify their main shortcomings and their impediments to productive activity and innovation.

The Review will make recommendations on the fundamental design of the business tax system, the processes of ongoing policy making, drafting of legislation and the administration of business taxation.

The recommendations will be consistent with the aims of improving the competitiveness and efficiency of Australian business, providing a secure source of revenue, enhancing the stability of taxation arrangements, improving simplicity and transparency and reducing the costs of compliance. The Review will adopt a comprehensive approach to reform driven by clear, sound principles involving a move towards greater commercial reality.

## Methods

The Review of business taxation arrangements will be open and transparent.

- Mr John Ralph, AO, will chair the Review.
- The Review will be able to call on the expertise of both the public and private sectors and academic tax experts.
- The Review is to report by 31 March 1999 to allow a reasonable time period for consultation with the business community, to allow draft legislation to be subject to consultative input from business and for the legislation to have effect from 1 July 2000.

## Outcomes

1. The Review will report on the state of the current arrangements relating to business taxation.

   This will involve reporting on:

   (a) the Australian business taxation system as a whole compared with international experience;

   (b) the structural flaws in the broad design of business tax arrangements and the degree to which existing business tax systems bias and impede business decisions;

   (c) the degree to which the current business tax arrangements meet the aims of certainty of taxation treatment, clarity of law, ease of administration and low compliance costs; and

   (d) the administration of taxation, including the drafting of legislation and technical corrections to legislation and the adequacy of existing procedures for consultation between the taxation authorities and the business community.

2. The Review will make recommendations about the fundamental re-design of business tax arrangements. While no aspect of the taxation of business entities and investments should be precluded from the scope of the review, consultations by the Review and associated recommendations will be directed to the strategy for reform spelt out in *A New Tax System*.

3. The Review will:

   (a) examine in relation to **business entities**, the re-designed company tax arrangements proposed to apply to companies, trusts, cooperatives, limited partnerships and life insurers — including a move towards consolidated group taxation and the achievement of a consistent treatment of distributions of profit and contributed capital;

   (b) examine in relation to **business investments**, the extent of reform in the areas of physical assets, financial assets / liabilities and intangibles and the potential use of accounting principles, taking into account the following considerations —

      (i) the need to encourage business development with an internationally competitive tax treatment of business investments;

      (ii) the potential benefits of bringing tax value and commercial value closer together;

(iii) the goal of moving towards a 30 per cent company tax rate;

(c) examine in relation to capital gains tax (CGT), the scope for:

(i) capping the rate of tax applying to capital gains for individuals at 30 per cent;

(ii) extending the CGT rollover provisions to scrip-for-scrip transactions; and

(d) need to achieve overall revenue neutrality in respect of (b) and (c) with these changes.

4. The Review will make recommendations concerning the question of consultative input from the business community into the ongoing processes of policy design, drafting of legislation and the administration of taxation.

5. The Review will make recommendations concerning possible improvements in the administration and the accountability of the taxation authorities in relation to business taxation.

PRESS RELEASE

NO. 81

Treasurer

**EMBARGO 14 August 1998**

**BUSINESS INCOME TAX CONSULTATION**

The Treasurer announced today the mechanism by which consultation with business will occur on the business tax reform proposals released as part of the Government’s tax package.

A New Tax System sets out plans for comprehensive reform of business taxes on two fronts:

- applying a framework of redesigned company taxation arrangements consistently to all limited liability **entities**; and
- considering the scope for more consistent taxation treatment of business **investments** with the prospect of achieving a 30 per cent company tax rate and further capital gains tax (CGT) relief.

A New Tax System indicated that consultation would occur with business on the proposed reforms.

The Government has decided to appoint Mr John Ralph to conduct this consultation. He will be assisted by the Tax Reform Task Force located in the Treasury.

Mr Ralph will be asked to report by 31 March 1999 to allow time for drafting of legislation and its passage, to have effect from 1 July 2000. Mr Ralph will be asked to take into account the views of small, medium and large businesses as well as rural and farming businesses. Submissions will be invited from the public, from business and other interested groups.

The terms of reference for the Review are attached. They have been drawn to allow comprehensive consultation and take into account the current problems with business taxation and the goal and strategy for reform set out in A New Tax System. The strategy in relation to reform of business entities is to consult on the proposed framework and on transitional and implementation details. The strategy in relation to business investments is to consult on the extent of reform against the goal of achieving a 30 per cent company tax rate and the prospect for further CGT. A requirement of the reform of business investments is that it is revenue neutral.

A stable, simpler and more coherent business tax system will provide a basis for more robust investment decisions, improved competitiveness, greater productivity, higher GDP growth and more jobs.

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**PRESS RELEASE**

**NO. 104**

# Treasurer

**EMBARGO** 27 October 1998

**REVIEW OF BUSINESS TAXATION**

On 14 August 1998, I announced the appointment of Mr John Ralph AO to chair a review of Business Taxation which will form the basis of a comprehensive new business tax regime under the New Tax System. Mr Ralph has commenced the Review.

To assist Mr Ralph undertake this important task, the Government has decided to appoint Mr Bob Joss, CEO of Westpac and Mr Rick Allert, Chairman of Southcorp to the Review. Mr Ralph, Mr Joss and Mr Allert will be assisted by a Secretariat which is located in Treasury. The Secretariat consists of officers from the Department of the Treasury, the Australian Taxation Office and the Department of Industry, Science and Resources, as well as a number of external advisers.

The Government had asked Mr Ralph to report by 31 March 1999 to allow a reasonable time period for consultation with the business community, to allow draft legislation to be subject to consultative input from business and for the legislation to have effect from 1 July 2000. The Government now considers this timetable does not allow sufficient time for consultations with the many interested groups representing small, medium and large businesses as well as rural and farming businesses.

The Government has decided to extend the date for reporting from 31 March 1999 to not later than 30 June 1999. To enable the Government's implementation targets to continue to be met, the Office of Parliamentary Counsel and the Australian Taxation Office will work with the Review team to prepare draft exposure legislation consistent with the Government's reform strategies announced in Tax Reform: not a new tax, a new tax system.

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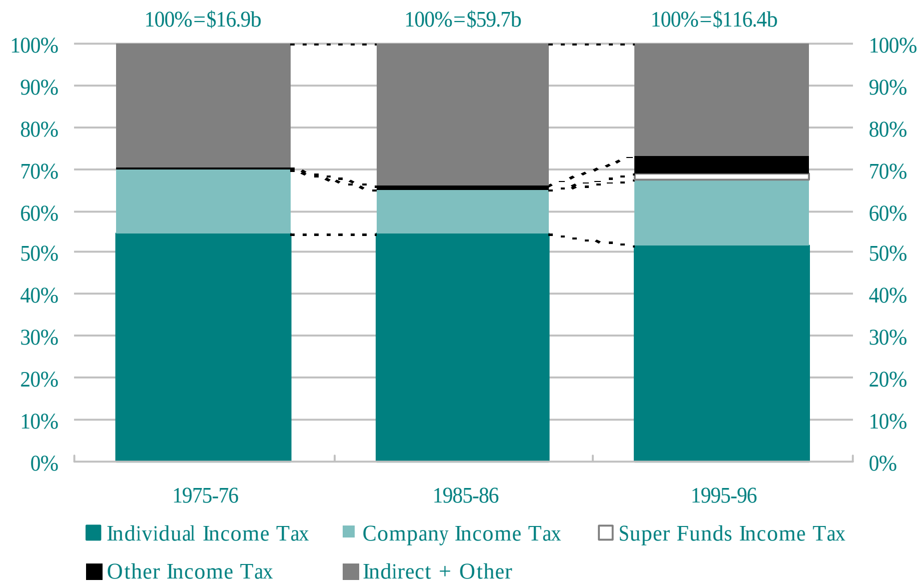
# *Background data on business income taxation*

## Total tax collected in Australia each year

1.1 Figure C.1 shows the total tax collected by the Commonwealth Government, from both business and non-business sources.

**Figure C.1: Commonwealth tax revenue by type of tax [(a)]**



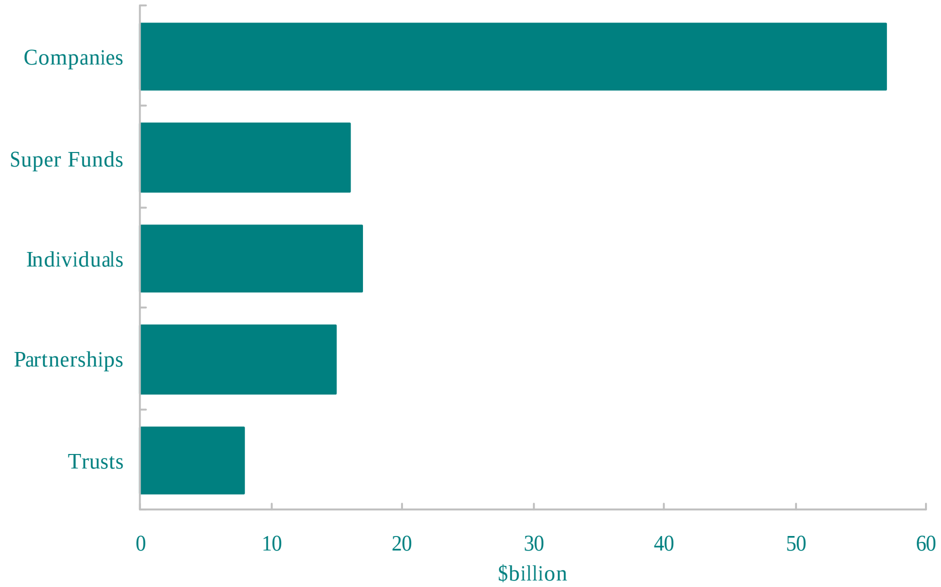

(a) Financial year data. Source: Commissioner of Taxation's Annual Report, Income Tax Statistics 1995-96 (published 1998)

1.2 The decline in the category 'indirect and other' is mainly due to the substantial decline in customs collections as a proportion of tax since 1985, reflecting the significant reductions in Australia's tariff levels. The growing category 'other income tax' includes Petroleum Resource Rent Tax, and Fringe Benefits Tax, which doubled in 1994 when it was applied to a grossed-up value and made deductible for company income tax purposes. This effectively moved about $1b from the company tax line into the FBT line. 'Company income tax' shows the substantial decline in company income tax to 1985, in the absence of comprehensive inclusion of capital gains in the income tax base, and its subsequent recovery. 'Individual income tax' declined as a proportion of total tax over the period, but includes salary and wage income as well as business income – that is, income from carrying on a business and other net gains subject to the business income tax system.

## Business income taxation

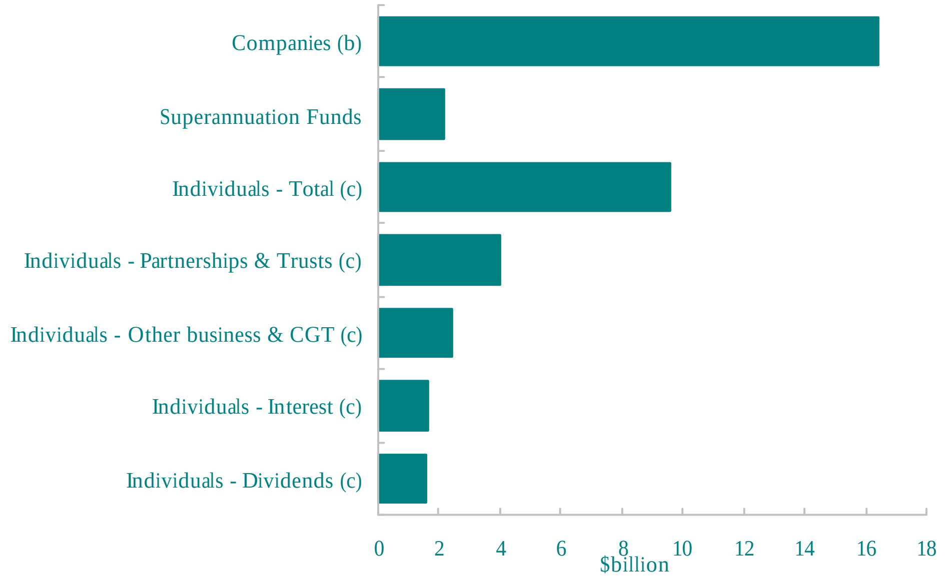
1.3 Figure C.2 and Figure C.3 show the source of taxable income earned in Australia and of business income tax paid. These two figures have been prepared on slightly different bases: the taxable income of individuals in Figure C.2 excludes dividends, to avoid a double counting of the income earned by companies, but the tax paid by individuals in Figure C.3 includes that relating to dividend income, after allowing for franking credits. Individual business income tax paid by individuals has been estimated by the Australian Taxation Office using calculated average personal tax rates.

**Figure C.2: Australian taxable business income by source, 1995-96**




Income year data. Taxable business income prior to application of prior year losses. To avoid double counting income has been attributed to its source. For example, dividend income has been excluded from individual income, as that business income has been included at the company level, and similarly, trust and partnership income flowing through companies and other interposed entities has been excluded. Source: Australian Taxation Office.

## Figure C.3: Business income tax by source, 1995-96[(a)]



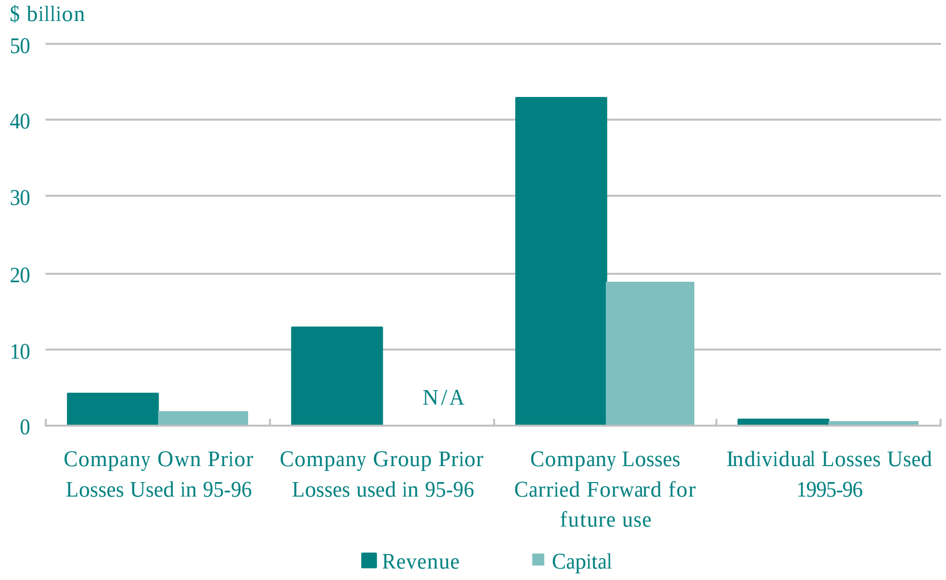

(a) Income year data.
(b) Due to the use of prior year and grouped losses, the amount of tax paid shown in Figure C.3 will differ from the taxable income shown in Figure C.2 multiplied by the statutory tax rate.
(c) Data for individuals are estimated using the average tax rate of individuals with some form of business.
Source: Australian Taxation Office.

1.4 Losses are a major contributor to the difference between accounting profits and taxable profits. The delayed recognition of losses for tax purposes and the possibility that some losses may never be deducted discourage risk taking and represent a major non-neutrality in the current approach to the taxation of business income. However, the ability of taxpayers to control the timing of the recognition of economic gains and losses under a realisations basis of taxation means that allowing a more generous treatment of losses would pose a significant threat to revenue.

1.5 Figure C.4 shows the extent of losses recouped in 1995-96 and the very significant amount of unutilised losses (losses carried forward), of both a revenue and capital nature, reported by taxpayers to be in the system. Actual tax losses carried forward are likely to be substantially greater. Reasons for this are that tax returns have not always required a statement of available carry-forward losses and many taxpayers do not complete this item in their returns, or do not complete it correctly.

1.6 Interpretation of loss data is also subject to the limitation that tax losses may not represent economic losses — for example, losses representing timing differences due to acceleration of depreciation deductions, or loss creation unintended by policy.

**Figure C.4: Reported tax losses used or available in future, 1995-96**




Source: Australian Taxation Office.

# Australian Taxation Office/Community: Current Consultative Arrangements

## NATIONAL TAX LIAISON GROUP

- Sub-Committee ATO/Tax Practitioners' Forum
- Sub-Committee FBT
- Sub-Committee CGT
- Sub-Committee Foreign Source Income
- Sub-Committee Transfer Pricing
- Sub-Committee Tax Treaties
- Sub-Committee National Review of Standards for the Tax Profession Working Party
- Nine Regional Forums
- Various Working Parties

## BUSINESS LINE FORUMS

- Corporate Consultative Committee
- National Sales Tax Liaison Committee
- Small Business Consultative Committee
- Superannuation Advisory Committee
- Various Working Groups and Technical Committees

## EXPERT PANELS

- Public Rulings
- International Rulings
- Part IVA (General Anti-Avoidance)
- Litigation
- Legislation (Proposed)
- Mediation (Proposed)

1. The above liaison arrangements provide for over 350 representative positions for community consultation.
2. Some representatives sit on more than one forum or panel.
3. Some additional regional forums and discussion groups are not shown.

## OTHER GROUPS/MECHANISMS AS REQUIRED

- Cash Economy Task Force
- TaxPack Advisory Panel
- Taxpayers' Charter Advisory Panel
- Tax Software Producers' Panel
- Draft Rulings Determinations
- Pre-Rulings Consultative Documents
- Discussion Papers
- Exposure Drafts