



6 June 2014

Dr Kathleen Dermody  
Committee Secretary – Senate Economics Legislation Committee  
Senate Standing Committee on Economics  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

Dear Dr Dermody

**INQUIRY INTO THE TAX LAWS AMENDMENT (TEMPORARY BUDGET REPAIR LEVY) BILL 2014 AND RELATED BILLS**

Thank you for your letter of 5 June 2014 on behalf of the Senate Economics Legislation Committee in relation to the Committee's inquiry into the Temporary Budget Repair Levy. As requested by the Committee we have reviewed issues that have been raised in submissions on which the Committee has sought further advice.

**Minimisation and avoidance [raised by Taxpayers Australia, the Tax Institute and Hayes Knight]**

A number of submissions raised concerns about the scope for individuals to avoid or minimise the effect of the levy. Examples included taking measures to change the year in which income or deductions are recognised to reduce their taxable income in the years to which the levy applies, or introducing arrangements to reduce their salary or wage by salary sacrificing for fringe benefits, including contributions to superannuation, or splitting salary through family trust arrangements.

As the income tax system, in large part, taxes individuals based on the amounts they receive and spend, individuals are able to affect the amount of tax they pay by altering their income or expenses for an income year. Similarly, as the tax system provides different treatment for certain types of payment or certain types of entity, individuals are able to choose to receive payments in a certain way or through a certain entity with the result that they receive different tax outcomes.

While such flexibility does provide individuals with some scope to reduce their tax liabilities, especially where the rates of tax change, it is a necessary feature of a tax in which liability is tied to individual's actual income for a year. Attributing payments to particular years regardless of when they actually occur or denying choices where they might result in tax benefits would be complex and impose considerable compliance burdens.

That said, there are substantial limits on this flexibility. As with elsewhere in the tax system, should individuals abuse this flexibility and seek to put in place arrangements driven solely by tax benefits, their behaviour will constitute tax avoidance and be subject to the general anti-avoidance rules in Part IVA of the *Income Tax Assessment Act 1936*. Further, there are specific anti-avoidance rules directed at preventing taxpayers from re-arranging their affairs to gain a tax benefit in the manner raised in submissions, such as rules in relation to the alienation of personal services income, pre-paid outgoings and advance expenditure.

### **Application [raised by the Tax Institute and Hayes Knight]**

Concerns were also raised in submissions about the application of the measure, both in relation to the tax rates that have been altered and in respect of the different commencement dates in respect of income tax and fringe benefits tax.

There are a number of specific tax rates that are aligned with the highest rate of tax that can apply to the income of individuals. The alignment of these rates is generally for the purpose of ensuring the integrity of the tax system – eg. the relevant amounts could be a substitute for income that would otherwise be taxed at this rate.

In many cases it may either be impossible or impractical for the marginal rate for the relevant individual to be determined when the tax applies (for example, fringe benefits tax is paid by employers, not individuals, and so the employer will not be in a position to know the tax rates applicable to each of their individual employees). In some cases, such as withholding taxes or excess non-concessional contributions tax, the use of this rate is also intended to provide an incentive for certain behaviour (such as providing tax file numbers for data matching or limiting contributions into the concessional superannuation environment). As a result, not matching any increase would give rise to opportunities for tax minimisation and avoidance.

These rates fall into two broad categories. Some rates apply to amounts that are not income or not income of individuals and so would otherwise be taxed differently or not at all. Others apply to amounts that are income of individuals but otherwise might not necessarily be taxed at the relevant rate.

The rates that fall into the first category will be increased by these Bills to include the rate of the levy. As the amounts subject to these rates generally do not otherwise form part of the income of an individual, they could otherwise escape the application of the levy entirely (for example, amounts subject to fringe benefits tax are not included in the taxable income of any entity).

The rates that fall into the second category have not been increased in these Bills to include the rate of the levy. As these amounts already form part of the individual's income they will already be subject to the levy if the individual is in the appropriate income range (for example, employment termination remainders form part of an individual's taxable income and are included in calculating the levy payable on this income). If the Bills were to increase these rates, it would result the imposition of the levy twice in respect of the relevant amounts.

After considering the issues raised by submissions, we have reviewed the proposed changes to the various tax rates and still think that they give effect to the Government's policy intention. We also note in relation to excess non-concessional contributions tax that work is underway to implement the Government's 2014-15 Budget announcement to provide a mechanism to ensure individuals are not excessively taxed and we expect the Government will consult closely with the sector to ensure appropriate relief is available to all taxpayers with excess non-concessional contributions.

With regard to fringe benefits tax, while the rate of fringe benefits tax is aligned with the highest marginal rate of income tax applicable to individuals (plus the rate of the Medicare levy), the income tax and fringe benefits tax have always applied over different annual periods. As these periods differ, to have any rate apply over the same period would require at least one tax to have a split period in which two different rates would apply. The compliance burden imposed on business by such an arrangement would be entirely disproportionate to the benefits of alignment.

Instead, where the relevant rate is changed, it is accepted that there will be a period or periods in which rates are not aligned. It should be noted that the small size and temporary nature of the levy will limit the likelihood of taxpayers taking action to avoid the levy.

**Complexity [raised by the Tax Institute and the Association of Superannuation Funds of Australia]**

Other submissions raised concerns that the proposal may be unnecessarily complex either in design or in terms of the time given to entities to change their systems.

Our view is that changes to income tax rates are among the simplest of tax changes.

On the timing for implementation, tax rate changes have often been announced on Budget night for application to the next financial year. The burden that a change in rate creates for taxpayers, especially sophisticated taxpayers, is minor (especially given that a change would be required in any case for the already legislated changes to the Medicare levy to fund the National Disability Insurance Scheme). As discussed above, having different rates applying for different parts of the tax year creates significant compliance burdens. Further, having a different rate apply for particular amounts, especially when, as with Departing Australia Superannuation Payments, the timing of payments is largely within the control of the taxpayer, poses integrity risks and is therefore generally inappropriate.

**Other issues**

The Committee has also asked if Treasury had any other observations in respect of the matters raised in the submissions. While we have reviewed all submissions within the time allowed and have no further comment at this time, we would be glad to provide further information should the Committee identify any additional areas of specific interest.

I hope this information assists the Committee. Please do not hesitate to contact Tania Constable (who has taken over from Rob Donnelly) or Chris Leggett should we be able to assist any further.

Yours sincerely

Robert Heferen  
Executive Director  
Revenue Group