Additional comments by Coalition senators

Schedule 1 – Exemption of income derived from foreign service

The proposal to remove the long standing general exemption from paying Australian taxation provided under section 23AG *Income Tax Assessment Act* 1936 has been introduced at very short notice, having been announced in the Budget on 12 May.

Considering the evidence given to the Committee of the confusion and inconvenience that will inevitably result from the introduction of this measure which the Government proposes to make effective from 1 July, Coalition Senators believe it would be more appropriate to allow for a longer period of consultation and preparation for those who will be directly affected by this measure. This would include the accounting profession, companies providing workers with work overseas, as well as individuals affected by the proposal.

Coalition Senators are concerned that this is a rushed and poorly thought through measure on the part of the Rudd government with apparently little or no regard having been given to the difficulties the proposed short lead-in time to implementation will cause for those directly affected.

In their submission, the Taxation Institute expressed concerns regarding:

> …the impact of the proposed amendment on:
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> • Individual taxpayers – it will add complexity to tax law and administration which will impact unfairly on ordinary Australians working overseas and limit opportunities for Australian workers to work overseas; and
>
> • Australian businesses - it will impose additional costs on Australian companies employing Australian residents overseas and therefore reduces their competitiveness and opportunities to expand their businesses internationally.[1]

According to the Treasury submission it is estimated that between 15,000 and 20,000 individuals could lose their exemption from domestic taxation under this measure. By contrast the Taxation Institute states that there are more than one million Australians working overseas – suggesting a much larger number of Australians who will at the very least need to consider or take advice about whether they will be caught by the amended section 23AG.

Coalition Senators have received literally hundreds of emails regarding this proposal from such Australians engaged in work in overseas locations from south-east Asia to Europe, Kazakhstan, Africa and the Americas. All write of the inconvenience the introduction of this measure will cause in disrupting their financial affairs and many regard the failure to give them time to prepare for the introduction of this measure as

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1 Taxation Institute of Australia, *Submission 19*, p. 1.

an indictment of the Rudd government for the lack of consideration shown to them and their families.

Reduced competitiveness of Australian contractors

One group which will be particularly affected by these proposed changes are consulting engineers, who were represented at the Committee Inquiry by their professional association, ACEA.

The ACEA believes the implementation of the proposed amendments to section 23AG will not only adversely affect the financial arrangements of their members working overseas (as mentioned in the previous paragraph) but also will result in a significant reduction in the competitiveness of Australian consulting engineering firms in winning international tenders. ACEA points out that in 2007-08, exports of engineering industries services were $1,334 million, representing 2.6 per cent of Australia's total income in service exports, which is significant. The ACEA also pointed out in their submission that "one international contract can result in flow-on work in the overseas region," thus leading to further business for Australian engineering companies.[2] The implementation of this proposal may accordingly result in reduced business opportunities for Australian contractors.

Coalition Senators are perplexed by the apparent failure of the Rudd government to consider the impact of the proposed measure on the competitiveness of Australian industry in bidding for international contracts. Again this is seen as evidence of this measure having been insufficiently thought through.

The accounting profession was particularly critical of the short timeframe the government has allowed before the planned implementation date of this legislation, 1 July 2009.

Witnesses representing accountants raised numerous concerns regarding the difficulties imposed by the short timeframe (of less than one month) in preparing advice to assist their clients in managing their financial affairs:

> Every single suburban accountant now will have to understand how the offset rules work. They will need to be informed of how tax paid can be estimated or determined in countries like the UK and New Zealand where you do not lodge tax returns for an individual, let alone with treaty countries. The issue is then whether the commissioner will enter into a whole series of arrangements to allow these million Australians to have different lodgement periods so that we do not get mismatches in payments. It is a mess.[3]

The Taxation Institute added further comments on the compliance cost of the measure as follows:

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2 Association of Consulting Engineers Australia, *Submission 18*, p. 5.

3 Dr Michael Dirkis, Taxation Institute of Australia, *Proof Committee Hansard*, 10 June 2009, p. 3.

> With over one million Australians working overseas, the compliance costs associated with this measure will be immense. Given this multi million dollar compliance cost imposition, the Taxation Institute is concerned that there has been no attempt by the Government to mitigate the impact of the new compliance obligations which will arise as a result of this amendment nor deal with the harsh financial effects arising from the interaction between the proposed s 23AG, the Foreign Tax Offset (FTO), Pay-as-you-go (PAYG), Fringe Benefits Tax (FBT) provisions and Australia's tax treaties.[4]

Both the Taxation Institute and KPMG have suggested amendments with respect to PAYG taxation, Fringe Benefits Tax and Foreign Tax Offsets. Coalition Senators are of the opinion that the issues raised in these two submissions are of serious importance and recommend that the government give full consideration to them.

Again, the fact that there are submissions by peak organisations that raise such serious issues does lend weight to the opinion that this legislation has been put together in haste and not adequately thought through.

Relocation issues

The government presumption that this amendment to section 23AG will raise $675 million in additional taxation relies on Treasury modelling which assumes that all taxpayers currently exercising this exemption will remain Australian residents for taxation purposes.

However doubt was cast on this presumption during the hearing when it was suggested that a significant proportion of Australians working overseas might rearrange their affairs to avoid Australian residency for tax purposes and relocate their "residence" to other countries such as France, Spain or the UK and work as fly-in fly-out workers from these countries rather than Australia.

The reason for their doing this would be to preserve their income status and family standard of living, which will be compromised by the introduction of this measure. Were this scenario to occur, it may be that the government may find that the estimated gains in taxation revenue derived from this proposal will prove to be illusionary.

Transition period

Coalition Senators are concerned that in their rush to introduce this measure the Government has not provided sufficient time for individuals who will be affected by these changes to consider the impact of the proposals on their financial affairs or for their financial advisors to prepare advice for them.

Coalition Senators are of the opinion that, in the interests of fairness and equity in dealing with citizens who in good faith have availed themselves of the exemptions provided by section 23AG, the government should consider delaying the commencement of this measure.

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4 Taxation Institute of Australia, *Submission 19*, p. 1.

Coalition Senators believe a transitional period would be appropriate, as this would give the Government sufficient time to consider implementing the amendments proposed by the accounting profession to this Inquiry.

Alternatively the Government could take the approach of 'grandfathering' the exemptions currently in place and apply the new arrangements to taxpayers seeking exemption under section 23AG from a later date by which time the legislation could have been reviewed and amended in keeping with the recommendations of the accounting profession.

Schedule 2 – Government Co-contribution for Low Income Earners

Through this measure the co-contribution scheme for low and middle income earners has been wound back; government contributions have been lowered by a third.

It is regrettable that the matching rate for the super co-contribution has been temporarily reduced from $1.50 to $1, as this compelling incentive has made the scheme enormously successful. Approximately 1.4 million Australians received a co-contribution in 2007-08.

Evidence indicates that the super co-contribution scheme and related matters are issues being considered by the Australia's Future Tax System (Henry) review. As such, Coalition Senators query why the government is acting before that review has been completed. Depending on the findings of the Henry review, these co-contribution changes may prove to be entirely the wrong thing to do and may work contrary to recommendations that may flow.

This measure, which takes effect from 1 July 2009, is called a temporary measure by the government as it has said it will gradually phase the co-contribution rate back up to 150 per cent from 2014-15. From 1 July 2009 the scheme will provide only a 100 per cent co-contribution for each of the financial years 2009-10, 2010-11 and 2011-12. In 2012-13 and 2013-14, 125 per cent of contributions will be provided and 150 per cent of contributions from 2014-15 onwards.

The maximum government contribution will be lowered from $1,500 to $1,000 in the income years 2009-12.

The co-contribution scheme has assisted pending retirees and other eligible workers to boost their account balances. Its removal will notably lower the incentive for individuals to make their own provision for retirement, thereby placing a greater burden on the taxpayers once they retire. This is particularly concerning as it was noted in the submission of The Association of Superannuation Funds of Australia (AFSA) that the level of voluntary contributions to superannuation is already down around 50 per cent on the level achieved a year ago.[5]

Coalition Senators consider the decision to be a retrograde one that may prove to cost more than it saves in the medium to long term.

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5 ASFA, *Submission 22*, p. 1.

Schedule 3 – Excess contributions tax

Concessional contributions which cover the compulsory Superannuation Guarantee and salary sacrificed amounts to super will be halved as at 1 July 2009.

The provision of adequate and sustainable retirement incomes for all Australians will be undermined by this proposal. According to the ASFA's survey statistics, a 55 year old with a balance of $250,000 in their superannuation account, on an actuarial return over 10 years of 5 per cent or less, will not be able to adequately provide for their retirement.

The existing level of concessional contributions was designed to provide a significant incentive for individuals to make their own provision for retirement. Changes to the level have the potential to severely undermine that incentive and, in particular, to remove the actual ability for people close to retirement to be able to afford to make provision for their retirement through large contributions.

The proposed measure sends a clear message to persons who may have had the ability to contribute significantly towards their retirement that the government is not supportive of them doing so.

This message is particularly poignant for those approaching retirement. From evidence at the hearing, not all individuals who take advantage of the existing provisions are particularly high wealth individuals. Indeed ASFA quoted a number of surveys and other data to support their claim that many are average income earners and people who do not have high value superannuation accounts. People who are approaching retirement have a lower need for disposable income (mortgage fully paid, children grown up) and are arguably in a position for the first time in their lives to make large contributions to their super.

In essence, many Australians earning around average incomes are unable to contribute additional amounts to superannuation in their 30s and 40s due to more pressing commitments such as raising children and repaying their mortgage. It is only when many such individuals approach retirement age that contributing extra to super becomes more feasible; and if they are to contribute enough to become self funding at that point, they need to be able to contribute large amounts and this is only a likelihood for most with the favourable tax treatment currently available.

As a partial way of addressing the consequences of the proposed measure, Coalition Senators also saw sense in the suggestion made by ASFA that the government put in place a higher cap for those with relatively low superannuation account balances to enable such individuals to catch up in their retirement savings through salary sacrifice.

Given the dramatic fall in voluntary contributions to superannuation funds over the past 12 months, if the government were serious about ensuring that as many as possible of the increasing proportion of Australia’s population approaching retirement made their own provision for that retirement, it would not be seeking to implement a measure such as this at this time.

A responsible government would see its role as encouraging self-funded retirement for as many Australians as possible. These amendments will likely cost the

Commonwealth significantly more in the long term as there will be more Australians calling on the public purse in the future.

Senator Alan Eggleston

Deputy Chair

Senator David Bushby

Member