Submission No. 30

SECURITIES INSTITUTE

3 October 1999

Ms Helen Donaldson
The Secretary
Senate Finance and Public Administration
References Committee
SG 60
Parliament House
Canberra ACT 2600

RECEIVED
10 NOV 1999
Senate Finance and Public Administration Committee

Dear Ms Donaldson

Inquiry into Business Taxation Reform

The Securities Institute of Australia (the Institute) represents practitioners in the securities and financial services industry. We would like to make a submission to the Committee on the issue of appropriate modeling for taxation policy.

The Institute has commissioned Access Economics to provide a report on the issues affecting modeling of taxation effects on revenue. The report will examine the traditional method of using only basic revenue changes against a model taking account of the flow-on effects of changed taxation policy, both in terms of behavioural change and whole of economy flow-through effects. The report should be available by 8 November 1999 and will be provided to the Committee as soon as it is available.

The Institute has not taken a position on the Government's specific proposal to change the capital gains tax rate and other measures in its proposals, other than the provision of rollover relief from capital gains tax for mergers and acquisitions and demergers. However, we are concerned to ensure that taxation policy decisions are based on realistic modeling, which properly takes account of the full effects of changes, that is both direct and indirect effects. The path of past taxation changes is littered with changes, which did not adequately take account of behavioural and flow-through effects, leading to ill-conceived changes. This has not been in Australia's best interests and should be avoided in the future.

We believe it is fundamentally important to ensure that the principle of flow-through modeling is confirmed notwithstanding arguments, which might take place regarding the underlying assumptions used in such a model. To reject that principle would ensure that future taxation policy decisions will repeat the mistakes of the past.

SECURITIES INSTITUTE OF AUSTRALIA | ACN 066 027 389 | Level 33, Tower Building, Australia Square, Sydney NSW 2000
TELEPHONE +61 2 9251 6799 | FACSIMILE +61 2 9251 6287 | E-MAIL info@securities.edu.au | WEBSITE www.securities.edu.au
PO BOX H99, Australia Square NSW 1215 Australia | DX 10438 Sydney Stock Exchange | INCORPORATING THE AUSTRALIAN SOCIETY OF SECURITY ANALYSTS

A simple example of the problems, which arise from using only the basic model may illustrate the point. For example, if a downward change in capital gains tax rates takes place, it will certainly lead to realisations being brought forward from a time when they might otherwise take place. Further, there are a number of consequences, which also flow from this behaviour. These realisations not only bring forward revenue from the capital gains, but they also lead to greater transactions and, therefore, income tax from intermediaries.

Further, the realisation will also put the realised asset to a new and, hopefully, more productive use. Ideally, this will involve investing in a new a more productive asset. This is indeed the behaviour being sought by policy makers in reducing the rate, as current rates tend to encourage assets to continue to be held regardless of performance, in order to avoid tax liability. Although this is not highly rational behaviour, it is the reality of human nature.

Through better investment decisions, which are not as driven by taxation considerations, government revenue increases through a variety of other means, particularly higher income and company tax returns lead by investment in better performing companies and assets. Income also flows from income earned by intermediaries in a more active market. Further, higher liquidity from a more healthy market assists economic efficiency, lowering the cost of capital and consequent debt levels. This further assists the revenue by reducing tax deductions.

There may also be negative behaviours, which may eventuate, such as creative shifting of income to capital. This needs to be taken into account and can be addressed by enforcement. However, it would not necessarily override benefits, which flow from reforms. Over-emphasis on these types of issues can be very detrimental to sensible reforms.

These points will be further expanded by us when we have received the report being prepared by Access Economics, which we will forward to you at that time.

We would also be prepared to appear before the Committee to explain our views and discuss the Access Economics report. We understand the Committee will be having further hearings on 11 and 12 November and we will contact you shortly regarding the possibility of appearing before the Committee.

Should you have any questions regarding this submission please contact me on (02) 8266 2872 or John Jarrett, our National Policy Manager on (02) 8248 7555.

Yours sincerely

Wayne Lonergan

Wayne Lonergan FSIA
National President