Labor should put pride aside on taxation reform

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While it sounds naive to suggest that a new government might consider implementing reforms initially announced by their predecessors, when it comes to Australia's clunky taxation regime, it's worth putting political pride to one side for the sake of an economy under pressure.

In terms of the levers over which Jim Chalmers has some control, the tax system can be readily adjusted to stimulate growth, increase efficiency and lower the compliance costs borne by taxpayers and the tax office.

An easy place to start is the long list of previously announced but unenacted tax measures. It's an opportunity for the Treasurer to pick some low-hanging fruit, with no likely (or defensible) pushback from the Coalition.

From the perspective of a tax lawyer, here's where I'd start.

For many years, the Australian Taxation Office had a clear and practical view of corporate residency. It required any company incorporated in an overseas jurisdiction to have both its central management and control and its business activities based in Australia before it was treated as an Australian resident company.

However, following a High Court ruling in 2017, the ATO updated its guidance around the corporate residency test to state that where a company was controlled in Australia, it was factually carrying on its business in Australia, regardless of whether any trading or investment activity actually occurred in this country.

This change dramatically increased compliance costs and uncertainty, particularly for multinational groups with foreign incorporated subsidiaries.

Under amendments proposed in the 2020 budget, foreign incorporated companies would only be deemed to be resident in Australia where they have a "significant economic connection to Australia". The test would only be satisfied where the company's core commercial activities are undertaken in Australia and the central management and control is in Australia.

The changes were set to enable taxpayers to apply the new laws retrospectively from 2017, which means that advisers are now operating in a grey zone of applying the ATO's updated guidance all the while anticipating that it will be fixed retrospectively.

As far as Australia's individual residency tax laws are concerned, they are widely recognised as being both archaic and difficult to apply. How can we encourage the best and brightest entrepreneurs to spend time in Australia if their residency position is unclear?

The previous government proposed a suite of new residency tests for individuals, centred around a "bright-line" test to deem a person to be a resident of Australia where they are physically present in Australia for at least 183 days. Although this will be trickier to enact than the corporate residency reforms, the government would be wise to pick this up and consult with industry.

Last year, the ATO finalised a ruling concerning the application of so-called non-arm's length income and expense rules, which have the potential to trigger billion-dollar tax liabilities that would ultimately be borne by ordinary members of large super funds.

Under the ruling, and by way of example, if a super fund incurs non-arm's length expenses in purchasing an asset, the income subsequently derived from that asset – and any future gain made on its disposal – will be taxed at the top marginal rate of 45 per cent.

The real concern though is that if a super fund incurs a general expense that is not connected with any particular asset, the ruling confirms the ATO's position that all of the income of the fund will be taxed at the top rate. This is an incredibly punitive outcome, and its impact will be exponentially more significant in the large regulated fund sector, where related parties routinely provide services such as asset management and other administrative services.

The previous government recognised the need to fix these rules and, just a few months ago, announced its intention to make legislative changes with effect from July to ensure these provisions operate as envisaged.

Australia has been giving up territory for years in attracting investors in the development of cutting-edge technology.

Our comparatively high company and personal income tax rates have diverted investors in research and development activities to jurisdictions that provide more concessional tax treatment on potential profits.

The patent box regime announced in Josh Frydenberg's last budget would encourage R&D investors back to Australia, particularly in the fields of medical and biotech, agricultural and low-emissions technologies.

The regime would operate by providing a concessional tax rate of 17 per cent for profits derived under this regime as opposed to applying the corporate tax rate of 30 per cent.

Despite the recent turmoil experienced by crypto markets, taxation of the digital economy and its intersection with traditional parts of the Australian economy remains largely unclear and untested.

The final report of a Senate committee on Australia as a technology and financial Centre identified areas of opportunity for the government to adapt our antiquated tax system to meet the challenges of the digital economy. Areas of concern include ensuring that digital asset transactions only give rise to capital gains tax where the transaction genuinely results in a clearly definable gain or loss.

The new government could and should also easily roll out the Digital Games Tax Offset, announced in March, which would introduce a 30 per cent refundable tax offset for eligible businesses that spend a minimum of $500,000 on qualifying expenditure.

As long as industry is appropriately consulted, all of the above actions can be taken without the time and expense of yet another review into the tax system.

The road to tax reform is already paved with many good ideas just waiting to be enacted.

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