

TAX VALUE METHOD

*ACCI SUBMISSION
TO THE
BOARD OF TAXATION*

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Background

The Australian Chamber of Commerce and Industry (ACCI) is the peak council of Australian business associations. ACCI's members are employer organisations in all States and Territories and all major sectors of Australian industry.

Through our membership, ACCI represents over 350,000 businesses nation-wide, including the top 100 companies, over 55,000 enterprises employing between 20-100 people, and over 280,000 enterprises employing less than 20 people. This makes ACCI the largest and most representative business organisation in Australia.

Membership of ACCI comprises State and Territory Chambers of Commerce and national employer and industry associations. Each ACCI member is a representative body for small employers or sole traders, as well as medium and large businesses.

TAX VALUE METHOD

Executive Summary

The Tax Value Method (TVM) has been considered at length and its development closely monitored by ACCI during the time it has been with the Board of Taxation.

On consideration of the TVM legislation and the likely impacts it would have on business ACCI support for the TVM was withdrawn. Moreover, the development of the TVM expressed in Prototype 4 further reinforces that the TVM does not have the potential to function properly and efficiently in the Australian economic environment. ACCI's resolution on the TVM from the General Council meeting of March 2002 is attached at the end of the submission.

The Prototype 4 legislation reveals flaws, complexities and significant compliance cost in the new tax legislation and ACCI would prefer that the Board consider other options for tax reform.

ACCI's position on the TVM is that:

- Considerable work has gone into developing the TVM with little consideration for other possible models. Despite this, the TVM is unworkable, uncosted and the introduction of TVM would cause major disruption and would lead to significant transitional and ongoing compliance costs.
- The benefits of TVM to business cannot be demonstrated and the latest legislation shows that there may actually be significant and unnecessary confusion created by the new tax legislation and hence the ongoing compliance costs would be as much a feature under the new system as they are under the current regime.
- The TVM cannot be accepted as a replacement for the current tax system since the evaluation process demonstrates that the TVM would not offer greater certainty or simplicity and would not deliver significant economic benefits over and above the compliance costs arising from changing to the new system. It is clear through the extensive evaluation process undertaken by the Board that assurances of simplicity and certainty are not possible.
- ACCI is not convinced that there are sufficient benefits to taxpayers in recompense for the transitional costs of moving to the new system. Moreover, the evaluation process has not demonstrated long-term benefits to individual firms nor to the economy in general. There is instead evidence of major increases in compliance costs especially amongst small business.

TAX VALUE METHOD

- The latest draft has enabled business to get a better understanding of what is involved in moving to the TVM in practice rather than simply a discussion of the concept. The fourth revision of the legislation has not allayed the concerns of business and indeed has only supported the criticisms. The benefits remain uncertain and the problems continue to mount.
- While in a global sense the TVM may be tax neutral, it would not be neutral for individual firms. The transitional costs remain large and there are many problems posed by the TVM for business that would make the shift to the TVM extremely risky.
- ACCI therefore opposes the introduction of the Tax Value Method. It believes business tax reform should remain high on the Government's agenda but that this particular proposal should be abandoned and instead efforts made to find an alternative through changes made within the existing framework.

Terms of Reference

The terms of reference issued by the Board of Taxation in their call for submissions on Prototype 4 in the Publication *Tax Value Method - An Overview* of March 2002 were:

1. Do you consider there is a need to address the complexity, inconsistencies and volume of Australia's current income tax legislation and related materials (such as explanatory material and rulings)?
2. Does the TVM concept have the potential to deliver the improvements needed in Australia's present income tax system?
3. What specific benefits or costs, including transitional costs, might the TVM have on taxpayers or tax practitioners, or both?
4. Are there areas in the prototype legislation that would require adjustment to ensure consistent outcomes with the current law apart from those areas where other policy initiatives propose variations to the existing law?
5. What would be the most efficient method and most appropriate timeline, if the TVM were to be implemented?

Comments regarding implementation could also address anticipated educational and skilling issues and any proposed alternatives to the structure used in the prototype legislation.

TAX VALUE METHOD

Tax Value Method (TVM)

The need to address the complexity, inconsistencies and volume of Australia's current income tax legislation

The current disarray that is the present income tax system should be reformed and ACCI supports the evaluation of options to address the problems inherent within the present income tax system. The complexity of the present system and the uncertainty created by the many disparate and yet overlapping income tax regimes and rules increases the costs to business, does not encourage foreign investment, encourages tax minimisation schemes and wastes businesses' energies on tax planning.

The present complexity of the various regimes that make up the income tax legislation in and of themselves makes interpretation difficult. The inconsistencies, however, which arise from the non-integration of the many elements within the income tax system, compound the problem. In addition, the many patches and fixes that have been devised and legislated have led to a significant volume of legislation that adds to the complexity of the two tax acts. ACCI supports the evaluation of measures to address the complexity of the present system with a focus on delivering certainty and simplicity.

Where it can be shown that a measure would reduce ongoing compliance costs and that this reduction in costs would be greater than the transition to a new system then business would be supportive of the changes. It has not, however, been shown that the current system cannot be crafted in such a way as to preserve the currently familiar concepts within the tax act but that reduces the complexity of the current system.

The TVM legislation packages a number of reforms together such as improving the capital gains legislation, dealing with 'black hole' expenditures, the taxation of financial arrangements and moving the treatment of income and deductions away from the income and capital distinction.

These improvements, however, are not solely features of the TVM legislation but could be undertaken within the existing framework. These features, therefore, should not be considered part of what the TVM can deliver. The TVM must be considered on the basis of what the tax value method can deliver. That is, what the shift from an income and deductions method to an assets and liabilities method can achieve for Australia. It is clear that the assets and liabilities model does not give more certainty, a reduction in complexity or reduce compliance costs. Moreover, the TVM may not be as robust as has been represented.

There should be a goal, in any attempt to improve the tax act, to ensure that at each instance an informed party seeks information on the tax

TAX VALUE METHOD

implications of a transaction that they can turn to the relevant section of the tax act and follow logical and well explained steps to arrive at a result.

The TVM concept does not have the potential to deliver the improvements needed in Australia's present income tax system

The criteria for business for any change to the current income tax arrangements must be based on making the tax system more straightforward, be more equitable, reduce the compliance cost burden on business and deliver greater certainty.

The TVM has not demonstrated that it can adequately accomplish these objectives. While a very useful experiment that has brought to light many significant developments which can be applied in further reform on the current legislation the TVM framework itself cannot be introduced.

The notion of a single model of a transaction based on tax values within a core concept, which applies to every transaction, has resulted in some great complexity for transactions that would be straightforward under the current arrangements. The one-size-fits-all model that is at the heart of the TVM leads to some illogical tax conclusions and hence additional complexity is introduced in the attempt to make every transaction fit within the core concept. The narrative of the TVM legislation as a result becomes fractured as more and more rules are introduced to force transactions into fitting within the core model.

Option 3 has demonstrated that significant simplification can be achieved through addressing the problems of the current tax system directly rather than attempting to create an entirely new concept, which may result in an entirely new set of problems. The current tax concepts are known and the deficiencies also known. In the analogy given by the Board of Taxation where it suggests that the Tax Act is like a road, an approach like Option 3 would repair and provide a solid foundation while the TVM concept would appear solid until one attempted to drive over it and found that the foundation had begun to crack.

The change from measuring income minus deductions to measuring the change in the *tax* value of assets against the *tax* value of liabilities and the matching of assets and liabilities over the length of time these are held would be extremely onerous for business. The steps involved in the calculation of tax under the TVM are more involved than under the current system where only two steps are required.

The fact that the TVM must track asset and liability over the length of time they are held by a party creates significant doubts about the claims that the TVM creates a more simple framework. The notion that a party must track whether a liability has changed its status from contingent to

TAX VALUE METHOD

non-contingent or that an asset has transformed adds considerably to the complexity of the legislation and if introduced would add to the burden a business faces calculating tax rather than reduce it.

The process of matching revenue against expenses is a familiar concept but is also fairly easily calculated in practice, except in some borderline cases and even here case law provides much guidance. The steps involved in calculating revenues against outgoings made in the process of generating these revenues, despite their being some black holes, are straightforward.

Much of the complexity in the current tax system stems from the fact that the legislation has been a creeping accretion of additions to the tax base, rather than a flaw in the concept of measuring revenue against expense.

If there is concern about black holes or other borderline situations within the current tax system these can be dealt with separately. There is no need to introduce a new concept to deal with these issues.

The reduction of the length of the law in a TVM framework has not been substantiated. The reforms that have been made on the CGT and the TOFA within the TVM legislation could also be undertaken for the present system. In addition, much of the TVM legislation only replaces other legislation and this new legislation is extremely complex and may lead to uncertain outcomes.

It is also unclear whether the TVM will present opportunities to avoid tax by assigning costs to zero tax assets or maximise liabilities for assets that do attract tax. Again it must be stressed that the deficiencies of the present system are known and should be dealt with rather than beginning again with an unknown and untested concept.

While the TVM itself cannot deliver the benefits needed for a wholesale change in Australia's income tax system, the process and some aspects of the work done on the TVM could. The process has been a remarkable breakthrough in tax legislation formulation and an important discovery of what is possible for the Board of Taxation in the future.

The costs that introducing the TVM will have on taxpayers

The costs to the economy of introducing the TVM will be great and may over the long run outweigh the possible reductions in the costs of calculating tax and estimating the tax consequences of transactions. The transition to an assets and liability system from income and expenditure will change the entire dynamic currently understood by business.

TAX VALUE METHOD

As is demonstrated by the introduction of the GST legislation, where we find two years on, that business is only beginning to come to grips with it, the change to TVM would have significant ongoing transition costs for a very lengthy period. Having already undergone a significant change to the way business is conducted in a GST environment and the significant costs to business that stemmed from the changes, business is resistant to any tax changes which would create additional transitional costs which may not be recouped in the form of reduced ongoing costs.

The additional costs imposed on business and the uncertainties for business of moving to the TVM framework leads to the opposition of the TVM by small, medium and large business - unanimously, despite each segment having slight variations in their objections.

The change to the TVM method from the existing method would be unacceptable to business. The extensive changes will require significant education expenses, retooling of software packages, and significant costs resulting in the need for increased levels professional advice, which may not subside in the long-run. These costs will be borne by the majority of business regardless of the size or the scope of operations. These transitional costs will be extremely onerous on business. Moreover, the ongoing costs to business have not been demonstrated to be lower that they are at present or even more importantly demonstrated to be lower that what would be achieved from a more suitable benchmark.

The ongoing costs of the TVM

The TVM concept has been developed as a cross between applying economic principles with accounting practices. However, the translation of the concept into working legislation adds much complex detail since accounting standards which the TVM seeks to employ cannot give enough detail to allow one to calculate tax down to a dollars and cents figure.

In addition, the many regimes and special provisions that have been enacted such as thin capitalisation, uniform capital allowance rules and the debt/equity distinction that exist outside of the core rules will remain and therefore much of the complexity of the present system will also remain.

The net income formula is not an intuitive concept and will lead to ongoing confusion and errors, which are a nuisance to business.

Consideration must also be made for developments that may occur at a later stage. The complexity of the core rules of the TVM may not allow for flexibility or changes to be easily accommodated in the future.

TAX VALUE METHOD

Additional policy decisions may become difficult to weave into the complexity of the TVM rules.

Moving forward

The criterion that business sought to have addressed by the TVM evaluation process were:

- . Is TVM better than the current system?
- . What are the long-term benefits for the average taxpayer?
- . Does the TVM remove the uncertainty of the present tax system?

It has become clear that these above assurances cannot be given and that it is unlikely that further work would be able address these business concerns. The evidence in fact points the other way, that TVM may actually increase the costs to business in the short term as well as in the long term. What business seeks is a stable and certain environment where the tax legislation is as clear as it can be made so that business can be less concerned with the tax implications of their business dealings and more focused on the dealings themselves.

The complexity introduced into the legislation from the drafting of the core rules should not be underestimated. The invented concepts and the added steps introduced to solve problems introduced by straightforward transactions only highlights the inadequacies of the inventory model to accommodate different sorts of transactions.

Therefore, ACCI can no longer support the development of the TVM as a replacement for the current tax system.

ACCI, however, applauds the work done by the Board of Taxation and would welcome more initiatives be undertaken with the same spirit and zest as shown on the TVM project.

Attachment 1

**Australian Chamber of Commerce and Industry
Resolution Passed March 15, 2002**

Tax Value Method (TVM)

“In an earlier decision Council indicated its support for the Tax Value Method (TVM) in principle but made it clear that the TVM could only be accepted as a replacement for the current methodology used to calculate business income for tax purposes if the evaluation process conclusively demonstrated that the TVM would offer greater certainty and simplicity and would deliver significant economic benefits over and above the compliance costs arising from changing to the new system. It has now become clear through the evaluation process undertaken by the Board of Taxation that no such assurances are possible.

“ACCI is not convinced that there are sufficient benefits to taxpayers in recompense for the transitional costs of moving to the new system. Moreover, the evaluation process has not demonstrated long-term benefits to individual firms nor to the economy in general. There is instead evidence of major increases in compliance costs especially amongst small business.

“The Board of Taxation has now revealed its fourth revision of the legislation but in doing so has not allayed the concerns of business. The benefits remain uncertain and the problems continue to appear large. While in a global sense the TVM may be tax neutral, it would not be neutral for individual firms. The transitional cost remain large and there are many problems posed by the TVM for small business that would make the shift to the TVM extremely risky.

“ACCI therefore opposes the introduction of the Tax Value Method. It believes business tax reform should remain high on the Government’s agenda but that this particular proposal should be abandoned and instead efforts made to find an alternative through changes made within the existing framework.

“ACCI does, however, note that the time and effort spent on the evaluation process has been a major step forward in tax design. The process has presented a model of how such tax reform should continue to be undertaken where there is a full consideration of all of the issues. The Board of Taxation should be commended for its extraordinarily thorough examination of the issues and should be encouraged to seek solutions to the current problems of the tax system.”