COMPANIES AND TRUSTS

[This Note summarises a number of problems and options for action which have been identified by tax experts, leading community sector organisations and other analysts as needing attention in the Henry report. TaxWatch itself does not express policy views.]

CORPORATE AND SHAREHOLDER INCOME

Some key problems

Australia's current corporate income tax rate is not very high by international standards (especially as most OECD countries also require employers to pay large social security contributions for their employees). Moreover, most overseas investors can already avoid paying tax on their dividends from Australia. Accordingly, there is no convincing case for reducing the current rate.

An unduly low corporate income tax rate deprives the government of necessary revenue and puts upward pressure on the personal income tax and GST rates. A large gap between it and the top personal income tax rate contributes to financial manipulation by wealthier taxpayers in order to receive income as a corporate entity (eg, by diverting income into private companies or pretending to be an incorporated contractor rather than an employee).

Some tax exemptions in relation to overseas subsidiaries encourage Australian businesses to transfer their operations to other countries. They also disadvantage Australian residents wishing to invest at home. Overseas lenders are taxed very little on their interest receipts while their Australian borrowers enjoy full deductibility for the interest paid. Full and immediate deductibility for interest expenses, in conjunction with capital gains being taxed only upon eventual sale and at a discount, unduly encourages heavy borrowing for speculation.

Options for Action

- ☐ Maintain or increase the corporate income tax rate to raise more revenue, especially for infrastructure investment, and to reduce the difference from the top personal income tax rate.
- ☐ Tax undistributed profits from private companies at the top personal income tax rate.
- ☐ Restrict the exemption of dividends and capital gains from overseas subsidiaries.
- ☐ Restore withholding taxes on all dividends paid from Australia to non-residents and broaden the scope of withholding taxes on interest paid to non-residents.
- ☐ Remove recently-provided exemptions from tax on capital gains by non-residents.
- ☐ Remove or reduce the 50% discount on capital gains tax for individual investors but restore indexation of the value of gains.

CORPORATE PAYROLLS

Some key problems

Other countries raise much more revenue than Australia from taxes which are based on payrolls and therefore are able to keep corporate income tax and other taxes lower than might otherwise be the case. On the other hand, this approach increases the cost of employing people. Also, much of the cost of paying the tax is probably recovered by companies cutting wages and/or increasing their prices to consumers. It may be less fair than taxing companies principally on their income as a measure of corporate profit and capacity to pay.

Australian payroll taxes are levied by the States. The extensive exemptions in individual States can cause unfairness between businesses and distortions in use of resources. Some employers seek to reduce their payroll tax liabilities by creating the appearance that some of their employees are actually independent contractors.

Options for Action

- ☐ Reduce tax-free thresholds for payroll taxes and reduce the rates.
- ☐ Remove or reduce payroll tax exemptions for particular types of employer (eg, local councils).
- ☐ Replace any cut in payroll tax revenue by increasing corporate income tax.
- ☐ Harmonise payroll tax systems between States.

TRUSTS

Some key problems

Discretionary trusts have proliferated and are vehicles for substantial tax avoidance by many high earners. This is partly because they facilitate splitting of income, especially with spouses and children, in order to reduce effective tax rates. They also give access to tax concessions such as the 50% capital gains tax discount which are not available through corporate structures. Their establishment and operation can divert substantial time and money from genuinely productive activities.

Options for Action

- ☐ Tax discretionary trusts in the same way as companies and provide beneficiaries with the equivalent of dividend imputation.
- ☐ Reduce the frequency with which proportionate allocations between trust beneficiaries can be changed.
- ☐ Tax distributed profits from trusts as if they are income in the hands of the controller of the trust.
- ☐ Strengthen enforcement of rules about independent contractor status.