Dear Chair

I appreciate the opportunity to provide a submission to the Productivity Commission's 5 Pillars inquiry. This submission focuses on creating a more dynamic and resilient economy and in particular the proposed tax reform measures contained within the Productivity Commission's interim report.

By way of background I am an Australian tax professional with over 30 years' experience, including very senior roles in both Big 4 accounting firms and very large globally listed multinational companies.

As noted in the report, the current design of Australia's corporate tax system is not fit for purpose when considering it through the lens of boosting investment and productivity. The Productivity Commission (PC) should be commended for thinking creatively about potential solutions and in particular the potential introduction of a Net Cashflow Tax (NCT).

The NCT, as currently suggested, does however have a number of shortcomings, including:

- It is proposed that the NCT will apply to all taxpayers. Any introduction of a new tax should be expected to increase the tax compliance burden on taxpayers, which would result in a reduction in productivity in the short term until such time as the new tax is sufficiently embedded.
- The NCT is a novel new tax with limited international precedents. As a result, it will be difficult and slow to implement with significant policy hurdles to overcome, such as the design of the starting base provisions for historical capital expenditure. Any lag between announcement and implementation of the NCT should be expected to result in a reduction in investment in the short term as companies defer investment decisions until the commencement of the new tax regime.
- Any new tax would be more difficult for the ATO to administer and would require new systems and processes.
- The interim report is predicated on the assumption that large multinational companies would not change their investment decisions following an increase in their tax rate. This is not correct. Large multinational companies have finite capital to invest in their global operations. Each country of operation competes internally for the limited capital to invest in its projects. Those projects are assessed globally on an after-tax rate of return basis, with capital being allocated progressively against those projects providing the greatest after-tax return. Any increase in Australian taxes would therefore reduce the after-tax return associated with Australian projects, which would then reduce their attractiveness against other global projects and reduce the capital being allocated to Australia.

Having regard to the above, I consider that a more appropriate way to achieve the PC's aims would be to implement the following:

1. **Stimulate investment by introducing a full expensing regime for all taxpayers within the current income tax system**

Such a system would be an extension of the temporary COVID measure previously introduced, applying to all taxpayers. The benefits of this approach, in contrast to the NCT, would be as follows:

- Well understood by the Australian taxpayer population with no additional compliance costs
- Easy to administer for the ATO and requires limited additional systems or processes
- Would reward increased investment
- Could be introduced quickly thereby having an immediate positive impact on investment and productivity without any initial negative short term impacts caused by implementation lags.

2. A new Alternative Minimum Tax regime that would be applied to Significant Global Enterprises (SGE)

Introducing a full expensing regime would naturally result in a reduction in income taxes paid in the short term as it results in the bringing forward of tax depreciation deductions that would otherwise arise in future years.

Having regard to the requirement for any new measures to be broadly tax neutral, this timing shortfall could be funded by the introduction of a new Alternative Minimum Tax (AMT), which has the effect of bringing forward tax payments for those entities that do not meet minimum tax thresholds.

Compared to the NCT, the introduction of an AMT would have the following benefits:

- More international precedents and therefore greater acceptance in the international market. Importantly the US has introduced an AMT.
- The new regime would only apply to SGEs and therefore any additional compliance burden would only be felt by large corporate groups that would have the resources to meet these additional demands.
- The use of the SGE definition for applying the new regime sits neatly with other measures aimed specifically at that cohort of companies (eg Diverted Profits Tax) and would be easy to understand by taxpayers and for the ATO to administer.
- The introduction of an AMT would raise additional taxes from those companies that do not currently meet minimum tax payment expectations. This cohort of companies has been the focus of ATO attention for some time and despite a number of new anti-avoidance measures continue to make minimal tax payments. An AMT would therefore help meet society expectations around all companies paying their fair share of tax.
- An AMT does not increase Australia's headline tax rate and therefore would have a reduced impact on Australia's international competitiveness.

There is some flexibility to how an AMT could be designed and implemented. However, efficient taxes are those that are simple to understand, comply with and administer from both a taxpayer and ATO perspective.

It is noted that, as a general statement, the majority of those profitable taxpayers that pay little to no tax make substantial intercompany payments to other group companies outside of Australia. Not all of those payments current attract Australian withholding taxes, as evidenced by the recent Pepsi case. An effective way to introduce an AMT would therefore be to target those intercompany payments.

A potential AMT design could include the following characteristics:

- Taxpayers would pay AMT to the extent that their income tax payments calculated under the current tax regime are less than a specified percentage (say 15%) of the companies taxable income before intercompany payments.
- AMT would be payable on the difference and would be treated as a prepayment of future income taxes. AMT payments would be creditable against future income tax payments once income tax payments started exceeding the AMT threshold, until such time as all AMT payment credits have been utilised.
- The rate of AMT (say 15%) would be set at a level that would be expected to fund the tax timing shortfall caused by the introduction of the full expensing measure. Importantly, this should be able to be accurately modelled as the ATO already has access to all the information needed to model the outcomes from data collected from existing tax return disclosures.
- The AMT could be designed to either give credit or not for any withholding taxes that have been paid on those intercompany payments. This could be factored into the modelling.

Example

By way of example:

	2026	**2027**	**2028**	**2029**	**Total**
Income	1,000	1,000	1,000	1,000	
General expenses	(300)	(300)	(300)	(250)	
Intercompany payments	(600)	(400)	(200)	(200)	
Profit/Taxable Income	**100**	**300**	**500**	**550**	
Gross Income Tax (30%)	30	90	150	165	**435**
Less AMT Credit (refer below)			(45)	(45)*	
Net Income Tax	**30**	**90**	**105**	**120**	
AMT Calculation					
Taxable Income	100	300	500	550	
Intercompany Payments	600	400	200	200	
AMT Income	700	700	700	750	
Gross AMT (15%)	105	105	105	113	
Less: Income Tax	(30)	(90)	(150)	(165)	
AMT Payment/(Credit)	**75**	**15**	**(45)**	**(52)**	
AMT Balance	75	90	45	0	
Total Payments	**105**	**105**	**105**	**120**	**435**

*Limited to brought forward AMT Balance

As can be seen from the below example, the design of the AMT would be to bring forward the payment of income taxes in those years where minimal income taxes would otherwise be paid. The example assumes changes in taxpayer behaviour to reduce the level of intercompany payments as a percentage of income. If that does not occur then AMT payments would continue to be higher than income tax liabilities and thus would represent a permanent increase in tax collections.

Importantly, the AMT design as indicated above requires no new information to be captured by taxpayers and relies on existing information contained within income tax return disclosures. The increased compliance burden on taxpayers would therefore be limited and only minimal changes to the ATO's systems would be required to administer the new tax.

I would be happy to discuss the design features of the new AMT with your team if this proposal is of interest.