



**SUBMISSION ON
RE:THINK TAX DISCUSSION PAPER**

MAY 2015

EXECUTIVE SUMMARY

1. ANZ welcomes the opportunity to respond to the Government's *Re:think* tax discussion paper. Taxation reform can increase job and economic growth, and help realise the opportunity presented by the rise of Asia. It can also make tax revenues more reliable and 'fit for purpose' in a digital age. Combined with government transfers, it can contribute to improved equity and fairness.
2. ANZ supports the Government's inclusive approach and believes that the tax system should evolve at a pace reflecting community support. Decisions about tax reform should not be taken unless the community has confidence in the benefits of reform, measures to ensure all Australians benefit, and the transition path and time frame.
3. In this paper, ANZ highlights three particular issues and responds to a number of *Re:think* questions. We look forward to participating in future steps in the reform process. The three issues are:
 - a. The tax system creates a bias against Australian investment in offshore businesses at a time when Australian businesses should be "on the ground" in Asia. Australian investors must pay tax at the full marginal rate on dividends from the foreign profits of Australian companies. Adopting the 2003 Board of Taxation recommendation of a 20 per cent credit for such dividends would address this bias and encourage investment in Australian-based global companies.
 - b. Interest withholding tax (IWT) on interest paid to non-residents increases costs to domestic borrowers, restricts sources of funds and places Australian financial institutions at a disadvantage compared to competitors. As recommended by previous reviews, ANZ believes that financial institutions operating in Australia should generally not be subject to IWT.
 - c. Payments on Additional Tier-1 Capital Securities are not deductible for tax purposes in Australia in contrast to the situation in offshore jurisdictions. This raises funding costs for banks and borrowers. ANZ believes that an approach similar to that in other jurisdictions should be adopted.
4. Responding to *Re:think* questions, ANZ considers that Australia's tax structure is not well suited to the global economy. Economically inefficient taxes or rates, such as the relatively high company tax rate and insurance or stamp duties, should be reformed. Simplification should be undertaken where there are net benefits taking into account transition costs. Promoting saving is an important goal. ANZ supports the imputation system and present treatment of property and other investment as means of promoting saving and investment. Moves to a more neutral treatment of different savings vehicles should be considered where there is a clear economic benefit and appropriate transition path.

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A. INTRODUCTION

1. ANZ welcomes the opportunity to contribute to the Government's *Re:think* tax white paper process and the wider conversation on tax.
2. We support the Government's comprehensive and inclusive approach. It is important to engage the wider community and allow complex issues to be discussed over time.
3. Decisions about tax reform should not be taken unless the community understands and has confidence in the case for reform, the impacts of proposed changes, measures to ensure all Australians benefit, and the transition path and time frame.
4. This submission provides a focused response to three issues of concern to ANZ as well as responses to particular *Re:think* questions. We take the view that there are important gains from reform but that the tax system should evolve over time.
5. Our submission seeks to take into account the interests of our approximately six million Australian customers and 500,000 shareholders, as well as the wider community. We believe our presence in 33 countries and our 'super regional' strategy means we are well placed to comment on how the tax system affects Australia's ability to take account of the opportunities Asia presents.
6. ANZ is assisting major business associations on more detailed submissions. We strongly support consultation by business with community and other stakeholder groups. We aim to be an active participant in discussing firm proposals as they emerge through the green paper stage.

Need for reform

7. After nearly a quarter of a century of uninterrupted growth, Australians are increasingly focusing on the strength, resilience and diversity of the economy. Rising public debt, commodity prices returning to long-term averages, ageing of the population and increases in social spending are recognised to be placing greater pressure on the economy and government finances.
8. Taxation reform can play a central role in addressing these issues. It can:
 - a. Increase job and economic growth and diversify the economy. This will better position Australia to realise the Asian growth opportunity emerging on the nation's doorstep.¹
 - b. Make tax revenues more reliable, predictable and fit for purpose in a digital and global economy. Modernising international and domestic tax frameworks to adapt to globalisation, the digital economy, and to eliminate inappropriate international tax avoidance is clearly important.

¹ ANZ expects Asia's share of global GDP to rise to 35 per cent in 2030 and be over half the world economy by 2050. "Caged Tiger: The Transformation of the Asian Financial System", *ANZ Insight*, Issue 5, March 2014.

- c. Contribute to fairness and equity. This needs to take into account that social outcomes are primarily achieved through government transfers rather than through the tax system.
 - d. Simplify and reduce the cost of tax compliance and administration. As *Re:think* notes, assistance directed to particular groups or issues, specific integrity measures, overlapping jurisdictions, and drafting complexity have all contributed to high tax administration costs.
9. Tax reform should generate benefits that are seen to flow to all Australians. The impacts of proposed changes on different groups, including consumers, savers and investors, and practical transition paths need to be considered in detail.

ANZ tax governance and transparency

- 10. ANZ's tax governance is reviewed and approved by our Board annually. It dictates a principle of low tax risk appetite, transparency and full compliance with the tax laws of the countries in which we operate.
- 11. ANZ opposes aggressive tax planning. The CEO has issued instructions to staff that ANZ does not enter into any arrangements that are designed to avoid or reduce the tax that we or our customers and partners owe. All employees must fully understand and comply with our policies on tax.
- 12. ANZ supports greater transparency and has published data on the tax paid by ANZ in the 2014 Corporate Sustainability Review.
- 13. ANZ supports efforts by the OECD and G20 as well as the Australian Government to modernise the international tax framework, reduce international tax avoidance and put in place sustainable rules to deal with digital and intellectual property-based services. ANZ believes that it is critical that this work is co-ordinated at an international level, as unilateral action risks placing Australia at a competitive disadvantage.

B. KEY ANZ ISSUES

Offshore investment and taxation of dividends from foreign-sourced income Q32. To what extent does the treatment of foreign income distort investment decisions?

- 14. Under Australia's tax system, Australian investors must pay tax at the full marginal rate on dividends from the foreign profits of Australian companies. They do not receive the equivalent of a franking credit or other discount. This creates a bias against Australian investment in offshore businesses and limits our opportunity to take advantage of the growth of Asia.
- 15. There are three key elements that form a framework for considering business tax in a relatively small, open economy like Australia. These are in addition to robust anti-avoidance measures. The role of each of these needs to be understood. ANZ is focused on item c, higher tax on foreign dividends. The three elements are:

- a. The *corporate tax rate* which affects investment in Australia by Australian and foreign investors should be internationally competitive to increase domestic business investment. A lower corporate tax rate means pre-tax rates of return can be lower than otherwise would be the case making more investments viable. This increases capital investment, boosts productivity and workers' incomes, and raises inbound investment.
 - b. Profits of *foreign subsidiaries of Australian companies* should be exempt from Australian company tax. Australia and most other OECD countries do not tax the profits of foreign subsidiaries (provided a subsidiary is not located in a tax haven) because those profits have already been taxed by the host country. This is a desirable feature of the Australian tax system that should be maintained.
 - c. *Income tax paid by investors* should be applied uniformly across different types of asset income to avoid biases. Australia is unusual in taxing foreign-sourced dividends far more heavily than local-sourced dividends.
16. Australian company shareholders face a 30 per cent higher statutory tax rate on dividends sourced from foreign profits (irrespective of the countries into which investments are made) compared to domestic profits. This also means that Australian investors will place a lower value on foreign assets or income streams than foreign investors who generally face a much lower rate on such dividends.
17. This discourages investment by Australians in offshore activity. It creates concentration risk for Australian investors and reduces risk adjusted returns. It creates an economic incentive for the foreign assets of Australian companies, or businesses that operate predominantly offshore, to be sold by domestic investors to offshore investors.
18. The bias against domestic investment in Australian-based companies with offshore business is important. At a time when Australian companies should be "on the ground" in Asian markets, the bias will discourage such Australian investment. Promoting Australian-based global companies is important:
- a. Australia is a relatively small economy. Australian companies need to invest outside Australia to grow and successfully compete against global companies with scale or specialised capabilities.
 - b. Income from offshore investment is an important means of diversifying the economy, reducing fluctuations caused by commodity cycles.
 - c. Economic research shows that businesses with high levels of offshore foreign investment make a strong contribution to the home economy. They are associated with particularly high levels of investment, research and development activity and high value employment. They are vehicles for commercialising scientific and technical research. Offshore investment results in higher domestic growth, and is not a substitute for home country investment.

- d. Global trade is increasingly based around business investments and local market presence rather than traditional exports of goods. This is particularly so for services such as finance and engineering.
19. While there are many examples of Australian companies' offshore successes, Australia as a whole has relatively low levels of outgoing foreign direct investment. There is limited policy focus on outgoing foreign investment and no regular statistical reporting of offshore investment by Australian companies.
20. To address the issue of tax bias, ANZ believes that a 20 per cent non-refundable tax credit should be available for the dividends paid from the foreign-sourced profits of Australian companies. This was recommended by the Board of Taxation in its 2003 Report on International Taxation to then Treasurer.
21. A 20 per cent, non-refundable tax credit would partly offset the bias against foreign investment. It would increase domestic investment in Australian-based global companies, contributing to the diversification of the economy and helping to realise the Asian growth opportunity. It would have no negative impact on overall levels of investment in Australia.
22. ANZ is currently finalising a detailed paper on this issue that it will publish in the coming months.

Q26. To what extent would Australia benefit from the mutual recognition of imputation credits between Australia and New Zealand?

23. In 2015, the Prime Ministers of Australia and New Zealand restated their support for a single economic market. Prime Minister Key noted New Zealand's interest in Australia's tax review given this goal and that the review will consider the mutual recognition of franking credits.
24. The current tax treatment of Trans-Tasman profits is inconsistent with greater economic integration of Australia and New Zealand. Dividends paid by Australian companies to New Zealand shareholders, and vice versa, are subject to double taxation.
25. ANZ endorses the importance of closer bilateral economic ties and the economic integration of Australia and New Zealand. The mutual recognition of imputation credits is consistent with these aims. ANZ also notes that recent economic modelling prepared by the New Zealand Inland Revenue Department at the request of the Australia New Zealand Leadership Forum concluded that the cost of mutual recognition to Australia is significantly less than previously modelled. ANZ notes that Australia and New Zealand are the only two countries with an imputation system, so that mutual recognition is an easily achievable goal.

Interest withholding tax

26. ANZ supports Recommendation 33 of the Henry Review that financial institutions operating in Australia should generally not be subject to IWT on interest paid to non-residents.

27. ANZ proposes that an IWT exemption should also apply to a wide range of financial services entities including special purpose vehicles used to raise funds offshore, funds managers and collective investment vehicles and similar entities.
28. While the rate of Australian IWT is 10 per cent, a number of exemptions reduce the amount that is collected. The Henry review stated that the effective rate is 3.5 per cent. The main exemptions relate to the public offer test, foreign superannuation funds and those provided for in some tax treaties.
29. The cost of IWT is borne by domestic borrowers who are required to gross up the payments of interest made to foreign lenders for the amount of IWT deducted. This increases transaction costs for domestic borrowers and restricts sources of funds. Borrowers respond to IWT by seeking to access funds where an exemption applies.
30. As there is no exemption from IWT for interest paid on deposits from non-residents, Australian financial institutions are unable to access this source of funding, putting them at a disadvantage compared to foreign banks that do not face this restriction.
31. In recent years, significant work has been done in promoting Australia as a financial centre in Asia. One aspect of this broader objective has been the clear intention to create a new Collective Investment Vehicle (CIV) that would serve as a vehicle to attract wholesale foreign investment. Australia is a small market for foreign investment and in order to compete effectively for foreign capital we must offer strong, consistent but flexible regulations and laws. The tax system should complement this objective, in particular application of withholding taxes. In order to attract foreign capital and to compete with the established markets of US, UK, Hong Kong and Singapore, investments by non-residents in CIVs should be exempt from all forms of withholding tax.
32. ANZ believes exempting financial institutions and other financial services entities from IWT would assist the development of Australia as a regional financial services centre. This was recommended in the 2009 *Australia as a Financial Centre: Building on Our Strengths* report (the Johnson Report). It would:
 - a. increase international competitiveness of financial services – many OECD countries with substantial financial services centres provide exemptions for IWT, eg the UK provides an exemption for interest paid by a bank to a non-resident in the ordinary course of its business
 - b. improve access to diversified sources of funding
 - c. reduce compliance costs in collecting IWT.

Tier 1 Capital deductions

33. Australia's banks need to attract capital to support the growth of their businesses and those of their customers. Capital includes both ordinary equity and Additional Tier-1 Capital Securities (AT1). The features of the Australian dividend imputation system, coupled with regulatory requirements, have resulted in major Australian banks raising all their AT1 requirements in franked format from the Australian retail market since 2008.

34. This has resulted in concentration risks for both issuers and investors, and heightened liquidity risks for issuers. Potentially, regional Australian banks may be crowded out of the domestic market and Australian and International institutions are excluded from the offerings.
35. The most efficient solution would be to permit domestically issued AT1 to be deductible for Australian tax purposes. This would overcome the inefficiencies in the current framework and align Australia to many overseas jurisdictions, including most of Europe, the UK, Singapore, Japan and New Zealand, which have either retained or moved to allow coupons paid on AT1 securities to be tax deductible. Such an approach would ensure major Australian banks remain internationally competitive and can efficiently access international capital markets.

C. CHALLENGES FOR AUSTRALIA'S TAX SYSTEM

36. The following comments respond to questions posed in the *Re:think* paper.

Q2. How well does Australia's utilisation of its available taxes align with the evolving structure of Australia's economy and changes in the international economy?

37. ANZ agrees with the *Re:think* observations that Australia's tax structure is not well suited to the global economy. Australia is disproportionately reliant on corporate income tax while competing for capital and mobile factors of production with other countries. Other countries have generally sought to reduce the economic costs of taxation by having lower taxes on capital and increasing the economic efficiency of how revenue is raised.
38. As noted previously, ANZ also supports efforts to modernise the international tax framework and put in place measures to address digital and intellectual property issues. Establishing these rules will not, however, address competition between sovereign nations to attract investment and are not a substitute for addressing underlying structural weaknesses in the Australian tax system.
39. ANZ notes the Treasury research that shows in the long run the majority of the burden or incidence of high company tax falls on workers.² We also note the analysis in *Re:think* of the relative economic efficiency of different forms of tax.

Q3. How important is it to reform taxes to boost economic growth? What trade-offs need to be considered?

40. Tax reform is an important opportunity to increase economic welfare, growth and resilience. The principal approach to tax reform should be to move the base of taxation from economically inefficient taxes to more efficient and reliable taxes. This can improve the prospects for all Australians, directly through economic growth and because it increases government revenues, allowing important social programs to be funded.

² The April 2015 Treasury Working Paper "Understanding the economy wide efficiency and incidence of major Australian taxes" states in relation to company tax that the "the marginal excess burden is largely borne by workers through lower real wages" (page 20).

41. As noted earlier, tax reform will shift the burden of tax between groups. Steps need to be taken to ensure all Australians can benefit and, equally, no group of Australians is made materially worse off from change. Detailed analysis of the distribution of impacts from potential change, and consideration of long-term transition paths, should be central to the discussion of reform.

Q4. To what extent should reducing complexity be a priority for tax reform?

42. ANZ notes *Re:think* data that Australian tax revenue is drawn from more than 100 different taxes but most revenue is collected from just a few taxes. The complexity of the tax system is increasing which drives costs higher and reduces certainty.
43. ANZ supports measures to reduce complexity and regulation, and to encourage a more pragmatic administration of the tax law, with appropriate revenue safeguards. These measures should be prioritised on the basis of the economic benefit arising from the particular change.
44. Making complexity reduction a priority in its own right risks reducing focus on major reforms. A clear benefit is needed to offset the likely costs of change such as changes to existing practices, business processes and systems.
45. Measures should be considered to reduce differences in taxation treatment of various forms of investment and savings, and rationalise complex tax structures. These should be supported if there are substantial and demonstrable gains for economic welfare.

Q5. What parts of the tax system are most important for maintaining fairness in the tax system? Are there areas where fairness in the tax system could be improved?

46. ANZ agrees that a tax system must be accepted by the community as fair. There is wide acceptance of a progressive tax system and that taxpayers in economically similar situations should pay similar amounts of tax. Companies and other entities should, and should be seen by the community, as contributing their fair share of tax.
47. Analysis of the fairness of outcomes should take into account both taxes and transfer payments. As *Re:think* sets out, Australia's tax and transfer systems taken together are highly progressive. The *Re:think* analysis sets out that transfer payments account for most of the income of the lowest 40 per cent of households. Around 17 per cent of individual taxpayers account for 63 per cent of total individual income tax.
48. As noted above, changes to the tax system should carefully analyse the impacts on particular groups. Many middle income Australians have saved and invested because of the present rules and should not be materially disadvantaged by change.

D. SAVINGS

49. Promoting saving is an important policy goal. Saving contributes to the security and well-being of individuals at all stages of their lives and supports the resilience and growth of the economy.

Q18. What tax arrangements should apply to bank accounts and debt instruments held by individuals?

Q23. What other ways to improve the taxation of domestic savings should be considered? How could they be applied in the Australian context?

50. Tax on savings differs according to the form of saving. Bank accounts and debt instruments face the highest tax rates. Interest paid on deposits is taxed at the marginal rate of the taxpayer.
51. ANZ in principle supports moving to a more neutral treatment of different savings vehicles where there is a clear economic benefit and appropriate transition path. In the case of taxation of bank accounts and deposits, lower tax on these forms of savings would likely increase deposit-based funding for banks and increase overall resilience of the financial system.
52. As *Re:think* suggests, the effect of these tax settings on aggregate saving is still uncertain. RBA research indicates that the level of savings, and the amount saved by sector, has varied considerably since the 1960s.³ There is limited analysis of the economic benefit of specific changes to the present structure.
53. Further analysis of potential changes affecting different forms of saving is needed. Interactions between forms of saving can be complex. For example, compulsory superannuation contributions are partially invested in wholesale deposits, assisting in bank funding.

Q20. To what extent does the dividend imputation system impact savings decisions?

Q25. Is the dividend imputation system continuing to serve Australia well as our economy become increasingly open? Could the taxation of dividends be improved?

54. ANZ supports the dividend imputation system. In relation to franked dividends from Australian companies, it eliminates double taxation of profits and creates an incentive for investing savings in active businesses. It encourages capital to be recycled to the most efficient uses, rather than being retained in companies. Australians place a high value on imputation.
55. *Re:think* suggests that there is no necessary link between saving levels (which would be affected by dividend tax treatment) and investment by business in a relatively small, open economy such as Australia with access to international financial markets. The *Re:think* argument is:

³ National saving fell from over 30 per cent of GDP from 1960 to 1970, to below 20 per cent in the late 1980s, and has trended higher since then. Household and government savings have volatile over this time. See "Trends in National Saving and Investment", James Bishop and Natasha Cassidy, RBA Bulletin, March quarter 2012, p.9.

- a. Australian firms have reasonable access to capital at international rates subject to relative risk and transaction costs (similarly savers have the opportunity to invest offshore).
 - b. Businesses are not dependent on domestic savings and can access international financial markets directly or through intermediaries.
 - c. Dividend imputation which affects saving levels does not increase investment or business activity.
56. Promoting Australian saving, and investment sourced from those savings, is, however, desirable in its own right. This is the case even though there may be no necessary link between domestic savings and investment in a relatively small, open economy. Local savings reduce dependence on more volatile external sources of capital, and are likely to be more easily sourced and have lower transaction costs. From this perspective, dividend imputation is a desirable incentive to promote saving.

Q19. To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?

57. The capital gains tax concession is an appropriate proxy for inflation adjustment of profits associated with long held assets. Taxing nominal gains of long held assets, without recognition of inflation would be a harsh treatment and result in lower levels of investment. The deferred nature of the CGT also recognises that capital income accrues in many forms and it would be overly complex to account for these different forms on an annual basis.

Q21. Do the CGT and negative gearing influence savings and investment decisions, and if so, how?

58. Discussion of capital gains and negative gearing usually arise in the context of property investment. In ANZ's view, investment in property is an important means of ensuring an adequate supply of rental and commercial property. Investment in property increases supply and would be expected to lead to a moderation in prices, except where there are development bottlenecks or lags.
59. In relation to negative gearing, ANZ notes the analysis in *Re:think* that any tax advantage for individuals investing in property does not come from borrowing but arises from taxation of the capital gain earned from the asset.
60. *Re:think* also notes that the tax treatment of investment properties is the same as it is for investment in any asset that produces a mix of current income and capital gain. This is appropriate. Singling out particular asset classes for additional tax would run contrary to a principle of neutrality and efficiency.
61. Recent price increases in Sydney and Melbourne have led to suggestions that this is driven by tax treatment of investment. This seems a contentious conclusion given the wide variation in price changes across Australia. Increasing prices in Sydney and Melbourne are most likely to stem from the attractiveness of, and development bottlenecks, in those markets. Increased housing supply and appropriate development policies are likely to ameliorate price rises over time.

Q22. How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

62. Low interest rates and high levels of global liquidity mean that returns on superannuation will be low for some years. The level of savings required for a comfortable retirement is likely to be systematically underestimated by many Australians.
63. Boosting saving for a reasonable standard of living in retirement through superannuation for as many Australians as possible should be a key policy goal. This should be supported by a stable and easily understood superannuation framework.
64. Australia's compulsory superannuation system is already overly complex involving a range of tax rates and caps applied at the contribution and benefit stage, and on earnings. In recent times, tax paid by high income earners and levels of allowed contributions have been pared back reducing confidence in system stability. The Australian system risks further complexity, for example through suggestions that unrealised gains in the benefit stage should be taxed.
65. A holistic and analytic approach is needed to assessing the efficiency, effectiveness and fairness of the retirement incomes framework. This needs to take into account the interplay between pensions, superannuation and other savings options available.

E. GENERAL BUSINESS TAX ISSUES

Q24. How important is Australia's corporate tax rate in attracting foreign investment? How should Australia respond to the global trend of reduced corporate tax rates?

66. Australia's relatively high corporate tax rate increases required pre tax rates of return on investments. As indicated by Treasury analysis, it would be expected that the burden of higher corporate tax rates largely falls on incomes rather than capital in open, competitive markets.
67. This is because high corporate income taxes raise the required rate of return on an investment and reduce productivity enhancing investment in the economy. Wages and salaries are lower than would be the case with greater investment and productivity.
68. Capital flows are sensitive to corporate tax levels. For this reason, OECD nations have generally been reducing corporate tax levels. Australia should seek a corporate tax rate which is competitive with regional nations and trading partners.
69. Reducing the level of corporate tax is an important economic benefit to Australia. It would promote investment and boost incomes. Australia should seek to achieve a level of corporate tax that is competitive with other economies.

70. As pointed out in *Re:think*, a transition to a lower corporate tax rate potentially has significant effects on Australian and foreign investors. These effects need to be considered fully.

Q34. How can tax avoidance practices such as transfer pricing be addressed without imposing an excessive regulatory burden and discouraging investment?

71. As noted, ANZ supports actions to modernise the international tax system. Australia already has some of the most robust transfer pricing and anti-avoidance rules in the world. Further measures taken in Australia should be consistent with OECD actions and international consensus. Independent action may result in Australia being at a competitive disadvantage.

Q52. What are the relative priorities for state and local tax reform and why? In considering reform opportunities for particular state taxes, what are the broader considerations that need to be taken into account to balance equity efficient and transitional costs?

72. Stamp duties, including insurance duties, are widely recognised as economically inefficient taxes. They are inefficient because they raise the cost of consumer and business transactions. There is also considerable variation between States raising costs for businesses and consumers. The removal of these types of taxes should be a priority given the potential net benefits from reform.
73. ANZ proposes that insurance duties in every State and Territory be abolished. Insurance duties are regressive and disproportionately impact lower income households. Abolition would improve equity by reducing insurance costs for lower income householders and risks of under-insurance. This measure is one of the only targeted means available to government to promote adequate insurance for lower income households. Abolition would also improve overall economic efficiency and simplify tax-related administration.