BUSINESS SA Submission to

Tax White Paper – Discussion Paper

June 2015

BusinessSA
South Australia's Chamber of Commerce and Industry

Contents

Introduction

As South Australia's peak Chamber of Commerce and Industry, Business SA is South Australia's leading business membership organisation. We represent thousands of businesses through direct membership and affiliated industry associations. These businesses come from all industry sectors, ranging in size from micro-business to multi-national companies. Business SA advocates on behalf of business to propose legislative, regulatory and policy reforms and programs for sustainable economic growth in South Australia.

Business SA's submission to the Tax White Paper discussion paper outlines our preliminary position on Federal tax reform and is part of a broader process involving the recently released State Tax Review discussion paper. As indicated at the recent business seminar on the State Tax Review, Business SA expects both the State and Federal tax review processes to deliver a tax system which provides the optimum level and structure of both State and Federal taxes. Businesses are agnostic as to whether or not they pay taxes at a State or Federal level, but they are demanding a system which the State Government has advised needs to 'support entrepreneurship, investment and job creation'[1].

Business SA is consulting its membership throughout the tax reform process and is being guided by a tax expert member reference group. It is important to recognise that our comments on the discussion paper are at a high level and will be further developed once specific revenue and economic impacts of various tax reform proposals are disclosed in the green paper. Only when representative organisations have a more complete understanding of revenue and economic impacts can various tax reform options be adequately considered in relation to one another. Furthermore, it is extremely important that all options for tax reform are costed in the green paper and not just those which may be more politically palatable.

The focus of our submission is primarily on the taxes which more broadly impact the decisions on businesses and which most influence wider State and Federal economic outcomes. Notwithstanding the Federal Government needs to undertake broad tax reform in order to facilitate tax cuts which support business, our views reflect the tax reform priorities of business, particularly small business.

As the voice of business in South Australia, we are genuinely encouraged by efforts from both the State and Federal Government to open the debate on tax reform. While the task of tax reform will always be a challenge for Governments, it is important that both levels of Government understand that competitive tension throughout the process will ultimately lead to optimum public policy outcomes. Tax reform is a once in a generation opportunity and considering South Australia's current economic malaise and the challenges we face beyond auto-manufacturing, it is certainly not one we can afford to squander.

In respect to the structure of the discussion paper, Business SA would like to acknowledge that many questions were not framed in the context of past tax rulings or in the broader context of how the tax system fundamentally operates. Any options delivered through the green paper must be properly framed to ensure stakeholders are able to provide responses in recognition of wider considerations and not in isolation of each other.

Should you require any further information or have any questions, please contact Rick Cairney, Director of Policy, Business SA on (08) 8300 0000 or rickc@business-sa.com.

[1] State Tax Review - Discussion Paper February 2015, P 6

Executive Summary

It is imperative that this round of tax reform actually delivers real relief to business from inefficient State based taxes, particularly payroll tax and stamp duty. The non-mining economy will not magically fill the void in Australia's economy without genuine tax reforms to increase investment in both capital and labour. Recent announcements in the Federal Budget are warmly welcomed, but they are no substitute for long term reforms to both company and personal tax rates to create sustainable economic growth.

The tax system must appropriately incentivise investment in income producing businesses and assets. It needs to foster growth amongst small businesses and reward risk and endeavour. The tax system must also work to more effectively attract international investment, particularly to leverage recent free trade agreements reached with China, Japan and Korea. Moreover, South Australia is currently assessing all possibilities for an expanded role in the nuclear fuel cycle and any outcomes will rely heavily on international investment. Australia must at least maintain parity with the OECD average company tax rate to ensure we are an attractive destination for mobile global capital.

Individual tax reforms must not introduce further complexity into Australia's tax system. Division 7A is a classic example of tax compliance where the overarching benefit of preserving integrity has been lost to the excessive complexity and cost to small business. The tax system needs to make it simple for small businesses to retain working capital. The ability to change legal entity structures to suit evolving business needs must be improved and we acknowledge the Budget announcement to provide capital gains tax relief for such restructures as a positive development.

Business SA accepts there needs to be a trade-off with tax reform to ensure Governments maintain a stable and adequate level of funding to deliver essential services and to provide an adequate social safety net. However, any trade-off to enable Governments to abolish inefficient taxes which stifle business growth must be restricted to the least amount of maximum benefit changes. Accordingly, the Federal Government should prioritise a review of the GST rate, and its base, as a means of abolishing payroll tax. The abolition of stamp duty can be enabled at a State level through broadening land tax which has already been canvassed during the current State Tax Review.

The discussion paper has appropriately recognised negative gearing as a fundamental feature of Australia's income tax system. Business SA supports negative gearing and reiterates the point that property is often the enabler of small business. Accordingly, stability of negative gearing arrangements is critical to small business confidence and future growth which cannot be ignored in a wider debate on housing affordability. Moreover, issues of affordability for first home buyers are often quite geographically specific and should not be dealt with through blunt measures in Australia's tax system. South Australia's economy should not suffer as a result of Sydney's booming property market.

The tax system needs to better enable Australia to grow its high tech enterprises and ensure our manufacturers and universities are appropriately incentivised to collaborate with one another; and not just through formal research and development partnerships. Australia's economy must continue to develop new and innovative products and services to maintain our trade competitiveness and ensure we can sustain our high standard of living. Australia's prosperity is not a given, but with the right foundations in a tax system which supports innovation, we will be well positioned for ongoing success.

Unfortunately the discussion paper is silent on how improved tax arrangements can encourage alternative funding of infrastructure, but this is becoming increasingly necessary to deliver economic infrastructure projects in an era of limited fiscal capacity at both the State and Federal level.

The Economic Case for Change

The South Australian economy continues to stagnate, with Gross State Product growing at just 1.3% during 2013/14[2]. The latest State Final Demand figures for the six months to December 2014 also indicate declining economic growth for the financial year 2014/15. Beyond that, Gross State Product is forecast to grow at just 2.5% in 2015/16, before declining to 2.25% for both 2016/17 and 2017/18 as the South Australian economy adjusts to the loss of its automotive production sector.[3]Business SA's March Quarter 2015 Survey of Business Expectations found a majority of businesses (67.3%) expect the South Australian economy to weaken over the next 12 months, compared with 25% forecasting stability and only 7.8% expecting growth.

Hopes of South Australia playing a significant role in the mining boom have been delayed by low mineral prices, particularly iron ore, while falling oil prices have depressed the short term outlook for the State's unconventional gas prospects. Future defence spending also remains uncertain despite assurances of South Australia's involvement in both the future submarine and frigates projects. On a brighter note, a recent run of average or above average grain crops have boosted the State's agricultural prospects, as have higher beef prices. Furthermore, horticultural crops including almonds and citrus are showing particularly strong promise. The recent decline in the Australian dollar has also helped to support South Australia's significant wine producing sector.

As at April 2015, South Australia's unemployment rate stood at 7.1%, the second highest of all States and Territories. Unfortunately this is combined with the 2nd lowest labour force participation rate amongst the States and Territories, 62.0%, which reflects both an ageing population and low confidence amongst job seekers. Youth unemployment at 21.6%, is 1.9% above the national average, and is reflected in declining apprenticeship commencements.

The State Government's analysis shows a falling age dependency ratio from 1.9 (working age people to dependents) in 2014 to 1.5 by 2031, a decline of over 26% in just 17 years.[4] With significantly less people working to support those underage or past retirement age, it is becoming more critical for the tax system to incentivise investment to create economic growth and job creation.

GST

The GST provides the largest single source of South Australian tax revenue and must be considered as a means to facilitate broader tax reform at both the State and Federal level. The GST is also a highly efficient tax being second only to land tax amongst all State and Federal Taxes. Business SA recognises the GST would be even more efficient if its base was broadened to include all existing exempt goods and services. We acknowledge that growing health expenditure will become harder to fund if the GST is not applied to the cost of health, particularly considering the Medicare levy only raised $10.3 billion in 2013/14 compared with total Federal Government health spending of $64 billion. We also recognise that Australia's GST coverage has slipped from 56% to 47% and is now below the OECD average of 55%, despite health expenditure being exempt from consumption tax equivalents in the vast majority of comparable developed nations. Education and basic food are also typical exemptions overseas or at least levied at a reduced rate.

While there is merit in leaving the GST base untouched in consideration of the existing system already being entrenched, Business SA accepts that this will depend upon how much revenue can be raised from raising the rate alone and whether or not additional revenue from broadening the base is

[2] ABS, Australian National Accounts 2013/14, 21 November 2014
[3] South Australian Government, Mid-Year Budget Review, 2014
[4] South Australian Government, State Tax Review – Discussion Paper, February 2015

necessary to facilitate the abolishing of inefficient State based taxes such as payroll tax. The green paper must clearly outline the revenue gains from specifically broadening the GST base to health, education and fresh food and other existing exemptions.

However, we do not support financial transactions being subject to GST due to the inherent difficulty in levying GST on loans and the limiting impact this would have on business investment.

Notwithstanding Business SA's position on extending the base of the GST is still subject to understanding the revenue impact, we do provide in-principle support to increasing the rate to 15% which should occur in two separate tranches of 2.5% per annum. We accept that there needs to be a revenue trade off to facilitate tax reform and considering Australia's GST rate is half the OECD average, there is a logical argument to firstly increase the rate before considering what, if anything, needs to be done to the base.

Business SA acknowledges that Australia relies more heavily on tax from income (company and personal) compared with other developed countries as well as our Asian competitors. This anomaly reinforces the case for Australia to shift further towards broad consumption based taxes.

As a start, the GST should also apply to imported goods above at least $100 in value, abolishing most of the existing exemption where GST is only payable beyond a $1,000 threshold. At the $100 threshold, the Federal Government[5] has determined enough GST revenue would be collected to offset the additional costs of administration.

Business SA agrees that Federal/State tax reform does not necessarily have to leap to a debate on the GST, but by the same token, no comprehensive tax reform can ignore the size and scope of the GST if we are to achieve a more efficient tax system.

Business SA acknowledges there may be some requirement for compensation through GST reform to protect those most vulnerable, but any moves to compensate need to be carefully considered in light of Australia's relative tax burden which the Federal Government acknowledges for a single average wage earner is 27 per cent, compared to approximately 31 per cent in Canada, the UK and the US.[6] It is also worth mentioning that compensation is not necessarily required to achieve policy reforms, as is typically the case under free-trade agreements which optimise economic outcomes for countries at a macro-economic level but may leave many businesses and individuals worse off.

The fact that the Federal Government is limited to amending the GST of its own accord should not be a barrier to pursuing a collaborative approach with State and Territory Governments to reform the GST. In fact, the Federal Government has a unique impartiality with respect to GST reform considering all revenues are returned to the States and Territories. In that sense, Business SA expects the Federal Government to lead the debate on GST reform to increase the overall efficiency of Australia's tax system and drive economic growth. Such growth is critical to growing Federal Government revenues and restoring structural balance to the budget.

As well as being efficient, the evidence suggests the GST is relatively stable when compared with taxes such as stamp duty. Furthermore, broadening the GST will improve its simplicity. While Business SA accepts the GST may not be strictly 'progressive', it does capture spending by high income earners on luxury consumer goods and it is equitable in the sense that no one, no matter how clever their accountant, can avoid paying the GST on a meat pie at the football. Moreover, we reiterate the point made in the discussion paper that 'while it is useful to understand the distributed effects of individual taxes, it is not the progressivity of any particular tax base that ultimately matters but, rather, that the tax and transfer system as a whole delivers fair outcomes.'

[5] Low Value Parcel Processing Threshold Taskforce, July 2012, P9

[6] OECD 2014, *Taxing Wages*, OECD, Paris, 21 November 2014

The reality is that despite any shortcomings of the GST, it does more to satisfy key principles of optimum taxes (efficiency, equity, simplicity and sustainability) than other State and Federal taxes being considered for reform and it would be a lost opportunity not to use the GST to help optimise Australia's tax system.

Business SA supports the existing structure of Horizontal Fiscal Equalisation (HFE) and does not see potential reform of this system as a barrier for the Federal Government to lead debate on reviewing both the rate and base of the GST. It remains our view that in the long run, all States benefit from HFE and any short term lobbying by States such as Western Australia will eventually settle in line with commodity price cycles. Furthermore, the Western Australian Government has now received compensation to offset its systematic GST revenue decline which should further encourage broad collaboration on GST reform.

Payroll Tax

Business SA has approximately 5,000 member businesses which we consult with on an ongoing basis to ensure we effectively advocate their needs. While we acknowledge the academic debate on whether payroll tax is a 'tax on jobs', we are guided by what our member businesses advise us and the way in which they behave in response to payroll tax. Payroll tax is limiting the expansion of businesses, particularly those below but approaching the tax free threshold, and does actually prevent job creation by small business. Whether or not this can be proven by empirical data, it still remains that the overwhelming anecdotal evidence demonstrates that businesses' hiring behaviour is being distorted by the presence of payroll tax. Payroll tax is also very difficult for small businesses to rationalise for it is not logical that they are penalised for employing people beyond a threshold.

Business SA surveys members on various tax reform options and can advise the following:

- In our September Quarter 2013 Survey of Business Expectations, when members were asked which State taxes or levies were most limiting to the expansion of their business and, if given the choice which would they reduce or abolish; a little under half (approximately 49%) of businesses surveyed nominated payroll tax. Other limiting State taxes or levies were WorkCover (24.1%), Stamp Duty (19%) and Land Tax (8%).

- In our pre-2014 election survey, members ranked 'progressively raising the payroll tax threshold' as the most important tax reform.

Business SA acknowledges the following excerpt from the State Tax Review discussion paper:

'An important factor when considering the fairness of a tax is who actually bears the ultimate cost. This can be different to the party that is legally required to pay the tax. For example employers are required to pay payroll tax, but as noted in various tax literature, the long-run incidence of payroll tax most likely falls on consumers or employees through increased prices or reduced wages.'[7]

This is supported by the Tax White Paper discussion paper which states that 'In the long run, the cost of the tax is likely to be passed onto employees (through lower wages) and consumers (through higher prices).

[7] State Tax Review - Discussion Paper February 2015, P 15

If the long-run incidence of payroll tax is absorbed by employees through reduced wages and by consumers through increased prices, logic suggests the long-run effect of replacing payroll tax with an increased GST should be to balance employee welfare through higher wages offsetting increased consumer prices. Concurrently, employers will be incentivised to create more jobs which will increase demand in the labour market and further enhance employee welfare.

In the lead up to the 2010 South Australian election, former Premier Mike Rann announced a four year relief plan promising to abolish payroll tax for apprentices and trainees. Unfortunately this tax exemption was subsequently abolished in the 2012/13 Budget. In a survey of its members, Business SA found that if the payroll tax exemption for apprentices and trainees had remained in place, three quarters of respondents would have employed more apprentices, and almost two thirds of respondents would have employed more trainees. This accords with the actual reported level of apprenticeship commencements which have decreased from approximately 7,000 per quarter as at July 2012 to approximately 3,000 per quarter as at September 2014[8]

International payroll tax equivalents are typically levied for specific social security requirements and are not necessarily entirely paid for by employers. Furthermore, not all comparable countries even levy payroll tax, including New Zealand.

Payroll tax is still considered a relatively inefficient tax, particularly when compared with the GST. However Business SA is disappointed that the discussion paper's key points ignore payroll tax in the following excerpt; 'Economic modelling suggests that the taxes with particularly high costs to economic growth are company tax and stamp duties.' While we acknowledge comments in a separate Treasury paper released following the discussion paper that payroll tax was ignored because of the complexity of exemptions and concessions across different states, it is misleading to make key conclusions in the discussion paper without reference to the reasons why payroll tax was not considered. Furthermore, 2011 analysis by KPMG which updated the Henry Review modelling shows the marginal excess burden of payroll tax is less than company tax and the two have a comparable average excess burden.[9]

Business SA recognises that Australia relies more on payroll tax in comparison to other OECD countries and despite it comprising only 5% of taxation revenue, it is still a large inhibitor for business to employing people. Accordingly, payroll tax reform should form a fundamental part of reform options proposed in the green paper.

The 2014 Board of Taxation report on tax impediments facing small business reiterated the 2009 Australia's future tax system report recommendation that payroll tax should eventually be replaced with revenue from more efficient broad based taxes.[10]

Stamp Duty & Land Tax

Business SA accepts that the abolition of stamp duty through the mechanism of broadening land tax is primarily a matter for the States and we have made representations on this issue to the State Tax Review.

Notwithstanding, we would like to acknowledge that South Australia's lack of action in removing stamp duty on non-real property transfers is acting to discourage interstate investors in local businesses, particularly when coming from States including Victoria which have already abolished such taxes. It is also a significant impediment to restructuring businesses within South Australia which

[8] NCVER, September Quarter 2014, P18
[9] KPMG Econtech MM900 model simulations
[10] AFTS, Report to the Treasurer — Part Two: Detailed Analysis (December 2009), Recommendation 57.

is compounded at a time of structural economic adjustment for the automotive production sector. From our discussions with auto-component manufacturers, diversification is often a very long and difficult process and there must be lower barriers to enable businesses to merge and salvage the most of existing operations, further enabling more time for diversification.

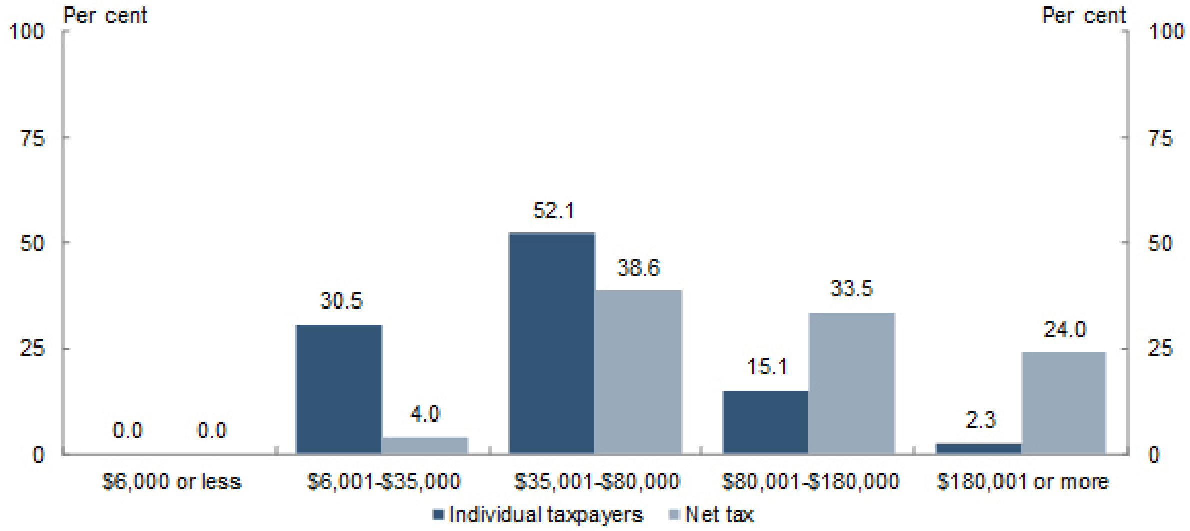
In Business SA's *2014 Charter for a More Prosperous South Australia*, we recommended the State Government abolish stamp duty on business transfers and non-quotable marketable securities as agreed in the Inter-Governmental Agreement on Federal Financial Relations. Such reforms should not necessarily hinge on outcomes related to broader reform of stamp duty which we reiterated in our recent submission to the 2015 State Budget.

Income Tax (Company and Personal)

The evidence from our accounting members strongly suggests that the misalignment of company and personal tax rates is resulting in a significant amount of tax avoidance. Considering the $40 billion cost of tax compliance to Australia's economy, the Federal Government needs to start the process of aligning tax rates on personal and corporate income.

Business SA acknowledges the situation of bracket creep which could see the percentage of taxpayers in the top two brackets (taxable income greater than $80,000) increased from 27 percent to 43 percent by 2024-25. Furthermore, we recognise that based on the ABS forecast wage growth, someone on average full-time earnings ($75,000) currently has an average tax rate of 22.7 per cent which is set to increase to 27.4 per cent by 2023-24. Additionally, someone with half that income ($37,500) will see their average tax rate increase from 10.3 per cent to 17.8 per cent.

However, the Federal Government must consider any adjustments of personal tax rates in light of Australia's existing tax-free threshold which already provides an acceptable support base for low income earners, particularly when compared to countries such as New Zealand which levies a 10.5% personal tax rate at the lowest threshold.[11] Furthermore, Business SA acknowledges the Treasury's 2013 Pocket Guide to the Australian Tax System which states 'The personal income tax system is progressive — the tax share increases for those who earn more, while those individuals who have limited means bear relatively little or no tax liability'



[11] New Zealand Inland Revenue, Income tax rates for tax year 2014-15

There is a strong preference from business to align Australia's company tax rate closer to the OECD average of 25% which also aligns with China's corporate tax rate. Recent successes of the Federal Government in securing trade agreements with Japan, South Korea and China have been applauded by business. However, in order to fully capture the investment opportunities which arise out of these agreements, particularly from China, Australia needs to be an attractive destination for foreign capital. Furthermore, many OECD countries significantly reduced corporate tax rates during and after the global financial crisis (GFC) and while Australia may not have been forced to take such steps, it is now apparent that we must become increasingly competitive on a global scale to bolster economic growth. By way of comparison, Canada's corporate tax rate was 36.1% in 2007 and is now 26.5%. Over the same period the UK has reduced corporate taxes from 30% to 20% and New Zealand from 33% to 28%. More importantly though for Australia's trade competitiveness, the Asian average corporate tax rate has fallen from 28% to 22% since the GFC.[12]

Business SA commends the Federal Government's 2015/16 budget announcement to reduce the company tax rate for small business to 28.5% and introduce a 5% tax discount for unincorporated small business of up to $1,000 a year. This are important first steps in achieving broader company tax rate decreases but a focus on further adjustments must still form part of the current tax reform process.

Dividend Imputation System

The existing dividend imputation is a fundamental part of Australia's tax system to ensure no double taxation for local investors. Business SA does not support any changes to the existing system which reduces the incentive for individuals to take risks through investing in domestic listed companies. Furthermore, many retirees or those planning retirement have structured portfolios around existing dividend imputation rules, including the refunding of franking credits. It will not necessarily be feasible or practical to rebalance portfolios on the basis of dividend imputation changes, particularly considering the costs associated with capital gains tax. If the Federal Government is looking at how to better enable domestically listed companies to attract foreign capital, it also needs to consider that many local investors are not necessarily comfortable investing in foreign markets and that local investment is likely to shift towards lower growth assets such as cash, bonds and property if dividend imputation is restricted or abolished.

Depreciation

The existing system of depreciation is deeply entrenched and broadly understood by small businesses and tax practitioners alike. Business SA advises against any changes to depreciation other than an increase in the instant asset write-off threshold to $20,000 for small business. Increasing this threshold from $1,000 had previously been recommended in the 2009 Australia's future tax system review and we commend the recent Budget announcement.

Notwithstanding our comments above, there is a case for the Federal Government to consider how the existing depreciation rules might be extended to capture the digital economy. Many tech companies do not necessarily have depreciable assets in the sense that traditional companies have fixtures and fittings and there may need to be discussion in the green paper of how the benefits of depreciation might be extended to non-traditional asset classes.

[12] KPMG, Corporate tax rates table, 2015

Tax Compliance Reform

➢ Division 7A (Part III, *Income Tax Assessment Act 1936*)

It is clear that the rules governing Division 7A are particularly onerous on small businesses and their practitioners. Business SA is mindful that the Board of Taxation's final report on 'The Post Implementation Review of Division 7A' is awaiting release and that it should contain recommendations to improve the efficiency of these cumbersome provisions.
We are particularly concerned about the following practice with respect to Division 7A:

'From 2009, the Commissioner of Taxation has taken the view, as outlined in Taxation Ruling TR 2010/3, that a Unpaid Present Entitlement (UPE) is capable of amounting to the provision of financial accommodation by the private company beneficiary in favour of the trust and may be a loan for Division 7A purposes'. [13]

While small business really struggles with Division 7A in its entirety, Division 7A was more manageable before the ATO ruling in 2009 relating to UPEs being treated as loans. Accordingly, this aspect of Division 7A needs to be prioritised for reform.

It should be emphasised that these changes were not brought about by Parliament at the instigation of Treasury but by the ATO taking a view that was contrary to the approach the ATO had adopted over many years dating back to when division 7A was first introduced. The present ATO interpretation remains controversial and Government should act to restore the original interpretation which will significantly reduce compliance costs and not result in any revenue leakage.

More broadly though, Division 7A is imposing a significant compliance cost on small business and Business SA strongly queries whether it is outweighed by the benefits of tax system integrity. Furthermore, many small businesses are actually creating new tax entity structures to better manage their obligations under Division 7A which is entirely unproductive.

Small business are primarily aiming to transfer funds between entities for working capital purposes and the existing system is based on the presumption that small businesses are seeking to avoid tax on personal consumption. To improve Division 7A, related entity transfers should be excluded and trusts should be better able to retain funds for working capital purposes. All small businesses, not just companies, must have greater flexibility to make valid business to business loans.

The inherent complexity of Division 7A is inconsistent with the Federal Government's goal to make a better tax system which delivers taxes that are lower, simpler and fairer. Small businesses' limited resources to engage tax practitioners should not be consumed by compliance measures such as Division 7A, but should be used to help businesses to optimise cash flow and grow.

➢ Tax Entity Structures

Business SA is of the view that a one size fits all tax entity structure may not work, but there must be improved allowances for businesses which need to expand as different structures become more appropriate to their needs. On this point, we commend the recent Budget announcement that small business restructures will not attract an immediate capital gains tax liability and that small businesses will be able to immediately deduct legal and accounting advice associated with establishing a business.

[13] Board of Taxation, Post Implementation Review of Division 7A – 2nd Discussion Paper, P15

The ability of small business to utilise different tax structures in a nimble manner is required for many reasons, not least of which is the unforseen nature of future needs. For example, while one tax entity structure may suit a particular business at a point in time, it may not be suitable five years down the track when the same owner may decide he or she wants to sell part of their business, not the whole business.

➢ Superannuation Compliance

Superannuation compliance is a considerable impost on small business, particularly in industries which rely on seasonal labour such as agriculture, horticulture and viticulture and any measures to streamline administrative requirements such as SuperStream should have broader eligibility.

Business SA acknowledges the following finding from the Board of Taxation's 2014 review of tax impediments facing small business:

'The Board notes the significant reduction in compliance costs SuperStream is intended to achieve for employers, including small businesses with 19 or less employees, once fully implemented. At that time, the need for an expanded clearing house service operated by the ATO could be revisited.' [14]

Negative Gearing

Business SA supports the Federal Government's view that negative gearing is a fundamental feature of Australia's tax system which allows expenses incurred in producing income to be deducted. The situation is no different to borrowing for an income producing asset such as shares where expenses, including interest, are deductible.

The fact that negative gearing supports property investment is actually quite positive for small business. Many small businesses leverage property to either start or expand a business and a healthy property sector is critical to a healthy small business sector. Any issues relating to the affordability of housing for first home buyers are typically more geographic in nature and Australia's tax system should not be used as a blunt instrument to restrain Sydney's property market.

It should also be acknowledged that negative gearing only benefits investors when they can take advantage of capital gains and despite the general commentary on certain overheated property markets in Australia, long term property markets are cyclical and there is no reason to believe future market trends will behave any differently. Negative gearing is part of the tax system to encourage individuals to invest in risky assets, including property. Commerce does not occur and economies do not grow if individuals and businesses do not take measured risks. Australia's prosperity to date has been a result of these risk takers and our future prosperity will depend upon them.

In relation to negative gearing's relationship to capital gains tax discounts, it must be remembered that the existing 50% discount was a trade-off against indexation which at the time was considered too complex to administer. If the Federal Government is to re-consider the structure of the capital gains tax discount, the net result must not leave individuals or small businesses worse off than under previous indexation arrangements.

14 Board of Taxation, Review of Tax Impediments facing Small Business, August 2014

Small Business Tax Concessions

Existing small business tax concessions are critical to incentivising the establishment and growth in small business and ensuring appropriate reward for risk and effort. Small businesses also have limited resources to establish and operate company structures and compliance is a much higher relative burden than for large businesses. Retaining cash flow and working capital is paramount for small businesses and accelerated depreciation is a strong incentive for small businesses to invest in plant and equipment.

Capital gains tax concessions for small business also provide a valuable incentive to grow businesses over time and any changes in this area must be carefully considered so as not to leave small business worse off than under an indexation arrangement.

While Business SA accepts that carry back loss provisions could be complex and difficult to administer, they did provide an important mechanism for small businesses to be able to optimise working capital through business cycles and their reintroduction should be strongly considered. Moreover, in a recent report the Board of Taxation acknowledged:

‘The Board notes the support for loss carry-back and acknowledges that, if properly designed, loss carry-back can advantage small businesses by providing additional cash flow during periods of temporary downturns. It can also create an incentive for businesses to undertake capital expenditure programs which may result in losses in the short term but enhance a business’s profitability in the longer term.’ [15]

Notwithstanding there are many valuable tax concessions for small business, it has become clear that the revenue threshold to define eligible small businesses needs to be revised. The existing threshold was last revised in 2007 and at $2 million no longer captures many businesses that generally display the attributes of a small business. $5 million is a much more suitable threshold for small business and accords with the recommended level from the 2009 Australia’s future tax system review which was recently supported by the Board of Taxation based on an analysis of business population data.[16]

While small business tax concessions are valuable, hard cut-offs do encourage behaviour from small businesses which is limiting to their growth. The tax system needs to support small business, but in a manner which also encourages them to grow and become larger businesses. As Treasurer Hockey stated on Budget night, tomorrow’s big businesses are today’s small businesses. Accordingly, the Federal Government should consider how small business tax concessions can be phased out to limit the disincentive for small businesses to expand. The Board of Taxation recently observed:

‘The hard cut-off also encourages significant tax-planning activity to ensure access to the concessions, and may even encourage some owners to limit the growth of their business. This appears to work against some policy objectives of the concessions (particularly the small business roll-over) to provide small business owners with access to funds for the expansion of their business.’[17]

Business SA also acknowledges the Board of Taxation guidance; ‘the submission that concessions should be ‘tapered’ off when thresholds are exceeded, rather than being forfeited completely, may partly address hard cut-off issues but may be complex and difficult to implement.’[18]

However, despite perceived administrative issues, Business SA recommends the fundamental shortcomings of small business tax concession hard cut-offs be addressed in the current round of tax reform.

15 Board of Taxation, Review of Tax Impediments facing Small Business, August 2014

16 Board of Taxation, Review of Tax Impediments facing Small Business, August 2014

17 Board of Taxation, Review of Tax Impediments facing Small Business, August 2014

18 Board of Taxation, Review of Tax Impediments facing Small Business, August 2014

Fringe Benefits Tax

Firstly, Business SA endorses the Federal Government's Budget announcement that salary packing of meal and entertainment expenses, including holidays, cruises and weddings, for some employees of not-for-profit organisations will now be subject to a $5,000 cap which is expected to save the budget $295 million over four years.

However, Business SA recommends the Federal Government further investigate generous salary packaging arrangements, particularly in the public service, which allow for some employees to effectively reduce their taxable income to $0. The public policy rationale behind such arrangements is questionable, particularly when the Government must consider all revenue options to enable wholesale tax reform which is required to foster long term sustainable economic growth. As Treasurer Hockey has repeatedly stated, the age of entitlement is over and there needs to be an acceptable cap on all salary packaging entitlements which strikes a balance between affordability and appropriate remuneration for employees of certain non-for-profit and public sector entities. Addressing such anomalies is also important to ensure that the business community and general public consider other reforms to Australia's tax system as being fair.

Business SA welcomes the Budget decision to allow a fringe benefits tax (FBT) exemption for small businesses that provide employees with more than one qualifying work-related portable electronic device, even where the items have substantially similar functions.

In the longer term, the fringe benefits tax rate should be aligned with the personal tax rate to better enable employers to take advantage of fringe benefits to attract and retain employees. For employers that can offer non-cash incentives, employees should not necessarily face an indirect tax at the top personal tax rate to receive such benefits. Like payroll tax, fringe benefits tax at the top marginal rate can work as an indirect tax on employees and ultimately operate to reduce their effective wages.

Aligning the rate of Fringe Benefits Tax with the personal tax rate also fits within a broader context of reducing personal tax rates.

Research, Development and Commercialisation Tax Incentives

There is still a large degree of uncertainty over what the future holds for companies in South Australia's automotive supply chain once Ford's Victorian factories shut in 2016 and Holden ceases manufacturing in 2017 with Toyota in close succession. While there is some Government assistance to help component manufacturers transition to new industries, diversification opportunities in an otherwise weak economy are quite limited and many companies are internationally domiciled with no strategic drivers to diversify their businesses solely to remain in South Australia. Furthermore, diversifying traditional automotive component manufacturers is a difficult and lengthy process. As a result there is likely to be significant unemployment issues in the short to medium term once excess workers are laid off with limited opportunities available in the broader economy, particularly if South Australia's naval shipbuilding industry does not materially benefit from the future submarine or frigates project.

The Federal Government should consider how the tax system can better encourage commercialisation of innovative research to enable long term economic growth. Notwithstanding the R&D incentive does work quite well for companies and is relatively generous by international standards, it does not necessarily promote increased collaboration between industry and universities. The R&D incentive is structured to suit longer term strategic research and development which is appropriate but the tax system should also work to support innovation at the small business scale.

The recent Budget measures to boost small business growth have been warmly welcomed by Business SA, but they must be complimented by long term strategic measures to boost innovation within small business. If the tax system could facilitate increased exchanged between small business and universities on a less formal scale than is allowed for under the R&D tax incentive, this could assist many small manufacturers to increase productivity or help develop new products without significant working capital requirements. For example, akin to the immediate deduction for legal and accounting advice to help start-ups in the Budget, small manufacturers could benefit from an immediate deduction for academic consulting advice to help improve production processes or develop new products. Upfront deductions for costs associated with intellectual property protection would also incentivise small businesses to collaborate with universities.

Business SA is working with its own manufacturing and university members to increase collaboration at a practical level, and our experience shows that once small manufacturers become aware of how university expertise and technology resources can help their business, there is strong interest in engagement. Notwithstanding many of these businesses may be equipped to access the R&D tax incentive, many are not and are not necessarily interested in formal research and development partnerships. The tax system does not necessarily cater for those small businesses, but to improve Australia's productivity and trade performance, innovation must be addressed at every level. Australian universities are generally ranked amongst the best in the world, with a range of university ranking indexes placing at least 5-10 in the top 100 and a further 10-15 in the top 400. We have the intellectual and technological capacity in this country and there are many examples where we are using this to leverage commercial outcomes, but to really drive our economy to the next level we need a tax system which strongly supports innovation at every level of business.

Special Industry Arrangements

➢ Fuel Tax Credits

Business SA supports the principle that governments must carefully consider special industry arrangements to ensure they are justified by strong public policy rationale. Our membership base spans all industries and we are quite mindful that specific industry concessions are ultimately paid for by all other members outside that industry which can only be justified on the basis of supporting a higher goal to grow the economy more broadly and benefit all industries.

There is a strong public policy rationale to provide a fuel tax credit for businesses which primarily use fuel (mostly diesel) for off-road use, predominantly in the mining and agriculture sectors. The historical policy intent of diesel excise has been to support government funding of road construction and maintenance and excise should not be collected from businesses where they are not using that fuel to increase the need for road construction or maintenance. The fuel credit is not a tax break for miners and farmers, but is available to all businesses which can demonstrate the use of diesel for off-road use, including many manufacturing businesses.

In 2006, partial fuel tax credits were also made available for on-road use by heavy vehicles above 4.5 tonnes GVM. Business SA acknowledges this concession was originally made available on the basis that the excise paid as a business input should be refundable. Furthermore, at the time the balance of excise for heavy road transport vehicles was converted into a non-hypothecated road-user charge. Accordingly, any moves to reform fuel tax credits for the road transport sector needs to consider all charges currently levied on heavy vehicles and not adjust fuel tax credits without appropriate consideration of how road user charges are collected more broadly. A competitive road transport sector is critical to South Australia's export competitiveness and must be a fundamental consideration of any tax reforms in this area.

➢ The Wine Equalisation Tax (WET)

The WET was introduced under GST reforms to ensure wine was taxed on an equivalent basis to that which applied under the previous sales tax regime. The WET is levied on 29% of the wholesale value of wine with producers able to claim a rebate of up to $500,000 per year, which equates to approximately $1.7 million in sales. New Zealand producers which have exported their wine to Australia are also eligible to claim the rebate. The producer rebate is particularly supportive of small producers and in a State like South Australia, these wineries are integral to our broad wine tourism offering which includes the iconic regions of the Barossa Valley, Coonawarra, McLaren Vale, Clare Valley and Adelaide Hills. Small family run wineries are the fabric of South Australia's wine industry and provide the character and hospitality that our wine regions are famous for.

The University of Adelaide recently conducted a study which compared Australia's rate of wine excise to other wine-exporting countries and found the following:[19]

- For 'commercial premium' wines (retailing at AUD12), Australia's 29% is the highest tax rate among the significant wine-exporting countries: the majority have zero taxes on such wines, France has 0.7%, South Africa 4%, the United States 6% and Canada 8%.

- For super premium wines, only Korea and Norway among OECD countries have a higher tax rate than Australia's 29%.

- When expressed in Australian cents per standard drink of alcohol, Australia's wholesale tax for 'commercial premium' wines (22 cents) is the same as New Zealand's, but at any higher price point Australia's tax exceeds New Zealand's. This rate compares to zero in Argentina, 3 cents in South Africa, 5 cents in the United States, and 6 cents in Canada – and just 1 cent in France and zero in the other Old World wine-exporting countries.

- Australia taxes wine relative to other alcoholic beverages more than most wine-exporting countries, the main exception being Chile where beer is very lightly taxed.

While we recognise the WET is not applied to exported products, it is still clear that Australian wine is already taxed at a high level, particularly compared with our international competitors. The Federal Government must be careful in how it addresses any anomalies with respect to the WET, including rebates to New Zealand producers, to ensure local wine producers are not taxed at an even higher rate through adjustments to either the WET rate or rebate. Furthermore, the example provided in the discussion paper on the relatively high taxation for ginger beer when taxed at a 'ready to drink' rate versus the WET rate which would apply with higher alcohol content is an isolated example and does not bring into question the policy rationale behind separate tax structures for wine compared with ready mixed drinks; which are both targeted for entirely different markets. If the structure of the WET had genuinely caused perverse policy outcomes, there would have been a surge in consumption of strong ginger beer which has obviously not been the case.

[19] Kym Anderson - University of Adelaide, Excise Taxes on Wines, Beers and Spirits: An Updated International Comparison, September 2014

Alternative Infrastructure Funding

Alternative funding of infrastructure is critical to the future economic growth of Australia and the green paper must properly canvas options to ensure the optimal tax treatment of long term infrastructure projects. A recent Business Council of Australia report prepared by PWC[20] made the following recommendations to improve the tax treatment of long-lived infrastructure investments:

- Support the current infrastructure tax loss incentive scheme
- Allow infrastructure investments to be treated as eligible investments for flow-through trust Taxation
- Allow unit trusts to utilise carry forward tax losses on the same basis as companies and
- Exempt interest and dividends from taxation.

These types of suggestions should be further explored to ensure Australia can maximise superannuation and other institutional investment in infrastructure. Unfortunately the recent Federal Budget funded no new economic infrastructure projects in South Australia, despite several advanced proposals put forward including the Northern Connector and the Northern Adelaide Irrigation Scheme. South Australian businesses are willing to consider user charges as a means to facilitate development of economic infrastructure, but we need both levels of Government to collaborate to ensure the regulatory environment enables investment which can leverage off this demand.

Furthermore, there is a fundamental willingness from superannuation funds to invest in Australia's economic infrastructure, but both State and Federal Governments must become more innovative in how they engage the sector to create investment models, and associated tax arrangements, which better align with the investment characteristics of superannuation funds, particularly SMSF funds. The scope for Australia's $1.6 trillion superannuation pool to become a larger driver of infrastructure investment is too significant not to be adequately addressed in the current round of tax reform.

[20] Business Council of Australia, Securing Investment in Australia's Future – Infrastructure Funding and Financing, P20