

## CHAPTER 8

### THE BURDEN OF TAX

#### Changes in Taxation Rates

##### *Wholesale Sales Tax*

8.1 The 1993 budget resulted in one per cent increases in the sales tax rates applicable to items affected by Schedules 2, 3, 4, and 5 of the *(Exemptions and Classifications) Act 1993*. Schedules 1 *Sales Tax* (exempt goods) and Schedule 6 (luxury motor vehicles, taxed at 45 per cent) remained unchanged. Schedule 7, relating to alcoholic wine and cider, commenced on 1 November 1993 at 22 per cent, increased to 24 per cent on 1 July 1994, and will again increase on 1 July 1995 to 26 per cent.

8.2 The majority of submissions which raised sales tax as an issue were primarily concerned about the timing of payments. However, the wine industry was concerned about the level of sales tax imposed on wine. In October 1993, the Government announced that a Committee would be formed to inquire into the winegrape and wine industry. That Committee of Inquiry published a draft report in March of this year and proposed that the form of the tax on wine should be changed through the imposition of a composite tax consisting of a sales tax component and a volumetric tax levied on the alcohol content. The majority of the Committee proposed that the average level of the composite tax be maintained at the 26 per cent of sales tax to come into effect on 1 July 1995. The minority report considered that the composite tax should be 50 per cent, with a five year transition to reduce transition costs.

8.3 In addition to the submission received from the wine industry, the Committee heard evidence in Adelaide on 20 April 1995. The major points of contention remain the proposed imposition of a volumetric tax, the existing trading stock valuation arrangements involving long term wine stocks, and the FBT.

8.4 The Committee does not consider that it is in a position to fully evaluate the issues involved and therefore has not attempted to influence the outcome of the inquiry by making recommendations concerning the substantive tax issues. Nevertheless, the Committee considers that a successful outcome to the Inquiry into the Winegrape and Wine Industry will not be achieved until the major protagonists find common ground and unless the attitude of the industry towards the measures which may be implemented as a result of the recommendations of the Committee of Inquiry are taken into account.

8.5 A number of submitters were unhappy with the requirement that sales tax payers act as unpaid tax collectors. The Beddall Committee had considered this to be a legitimate complaint by small business and had recommended that compensation in some form be provided to small businesses, possibly by providing a tax credit based on an agreed reasonable compliance time spent dealing with sales tax paperwork.

8.6 The Committee recognises these factors, the fact that the burden of sales tax collection is not readily absorbed within the economies of scale available to large businesses. and considers that it would be appropriate for the Government to address this issue at some future stage.

##### *Excise*

8.7 No major concerns were expressed to the Committee about the increase in excise since the 1993 budget. However, the *Customs and Excise Legislation Amendment Bill 1995*, which proposed to exclude certain categories of

taxpayers from diesel fuel rebates attracted considerable adverse comment. It was referred to the Senate Economics Legislation Committee which conducted a public hearing on 23 June 1995. A report was tabled in the Senate on 26 June 1995 dealing with the matter.

### *Company Tax*

8.8 Australia levies a relatively high company tax rate which, coupled with high compliance costs associated with the range of taxes affecting small businesses, provides grounds for a concession to small business. There is a problem of establishing a suitable threshold for such a concession as it is difficult to establish from available statistics any reliable correlation between tax collections, business incomes, and number of employees receiving salary and wages.

8.9 Overseas countries, such as the UK, which use a two tiered company tax system, rely on levels of taxable income to establish an access threshold to the lower tax rate. However, this is not necessarily a reliable indicator of business size because the bulk of company business income is reduced through deductions. Furthermore, even very large businesses can experience a downturn which temporarily reduces their level of taxable income. The Committee considers that this issue should eventually be addressed and if implemented, an appropriate composite threshold be adopted which takes into account both profits and number of personnel within the company.

### **Compliance Costs**

#### *Wholesale Sales Tax*

8.10 The current application of the *Sales Tax (Exemptions and Classifications) Act 1993* contains complexities and ambiguities in relation to the classification of many goods, and categories of goods, particularly new products emerging in the market. It is clear that the Act needs clarification, as do the associated processes which determine the classification of new products.

#### Recommendation 3.2:

The Committee recommends that the Government conduct a comprehensive review of the sales tax exemptions and classifications system with a view to:

- (i) removing the ambiguities and complexities within and between the sales tax classification schedules; and
- (ii) establishing a simple, effective process whereby the classification of new products can be quickly and simply achieved, thereby lessening reliance on the general rate of sales tax as a default rate.

#### *Fringe Benefits Tax*

8.11 The complexity of FBT, and its associated cost of compliance, leads the Committee to consider that a small business which has a very low FBT liability, and whose contribution to revenue is less than the cost of calculating the amount payable (about \$200), be exempt from FBT.

#### Recommendation 4.1:

The Committee recommends that small business be exempt from annual FBT liabilities of \$200 or less.

8.12 The fringe benefits tax (FBT) was introduced to tax non-cash remuneration which were not previously taxed. Although these fringe benefit are items of remuneration received by the employee, they are not taxed as employee benefits at relevant marginal rates, but as employer benefits at the top marginal rate.

8.13 The Committee is concerned that the fringe benefits tax base, which was originally designed to trap 'lurks and perks', has expanded to include statutory and other compulsory benefits. The employer has no choice but to offer these benefits and does not have the option to cash them out into wages or salary. These should not be subject to FBT but should be treated as part of an employee's income and levied at the employee's marginal rate.

**Recommendation 4.2:**

The Committee recommends that statutory and compulsory award obligations from which an employer is prohibited from cashing out into salary or wages be exempt from FBT.

8.14 The Committee does not believe that car parking should be subject to the FBT as they are often required by local government, cannot in any case be cashed out as they represent structural assets of a company, and do not readily lend themselves to private use by employees.

**Recommendation 4.3:**

The Committee recommends that car parking be exempt from the FBT.

8.15 The Committee does not consider that industry based child care should be discouraged or burdened with FBT, particularly if small businesses are offering the benefit.

**Recommendation 4.4:**

The Committee recommends that child care be exempt from the FBT where a number of small businesses combine to provide child care exclusively for the children of the personnel employed by those businesses

*Notification of Changes*

8.16 The Committee was concerned that changes to the company tax payment arrangements which took effect from 1 June 1995 may be adversely affecting company taxpayers with tax liabilities in the \$8,000 to \$20,000 range. These taxpayers, which number over 20,000, were previously able to exercise the option of paying their liability in a single lump sum instalment in December. The new arrangements require quarterly instalments commencing from 1 June 1995. Evidence indicates the possibility that some of these companies may be suffering cash flow disruptions because the first instalment was brought forward without adequate notification.

**Recommendation 5.1:**

The Committee recommends:

- (i) that the Government investigate the adequacy of the notification of the new company tax arrangements, in particular, to those companies with company tax liabilities of between \$8,000 and \$20,000;
- (ii) that the Government ensure that taxpayers which are affected by changes in the legislation are properly notified well in advance.

### *Double Taxation*

8.17 The Committee suggests that subsection 47(1A) of the ITAA, which may result in small companies being subject to double taxation on the disposal of an asset and subsequent liquidation, be amended.

#### Recommendation 6.2(ii):

The Committee recommends that section 47(1A) of the ITAA which ignores nominal capital losses and depreciation when calculating capital gain to be added to income, be reviewed and amended, if necessary.

### **Small Business Statistics**

8.19 COSBOA submitted that there is very little information in circulation to support any policy discussions which may occur concerning the treatment of firms on the basis of size, pointing out that analysis is based mainly on other criteria.' Contending that the relative absence of size related data is a major impediment to public debate, COSBOA recommended that the ATO be required to assist small business policy debate by publishing aggregated tax data, arrayed by business size.

8.20 ATO and Treasury officials advised the Committee that there are no real impediments to publishing the kind of size related information sought by COSBOA. Discussions had been held between the ATO and COSBOA to ascertain what sort of information they were seeking to enable the ATO to determine what work would need to be done to their administrative systems to accommodate COSBOA's request.

8.21 An associated problem appears to be the question of thresholds which are designed to take business size into account. There appears to be inconsistencies in the various thresholds that have been adopted in relation to the various taxes. When questioned about these anomalies, the ATO acknowledged the issue, giving as an example the different thresholds applicable to FBT return lodgement and quarterly payments compared to the arrangements that apply to company tax.

8.22 COSBOA argued in their submission that the inconsistency in business thresholds '... spring from a practice in government of thinking from the top down', and that when a new policy is implemented, it is done so '... with too little appreciation of its full impact on small firms. 'Unintended consequences' then emerge and a "threshold" is applied later to isolate the problem... which invariably relate to *on costs* which develop for small firms through excessive "paper burden".

8.23 Variations upon this theme emerged consistently throughout the evidence. For example, Howard Pender suggested in his submissions to the Committee that one of the greatest problems faced by small business dealing with

regulation and tax is a "big business paradigm" held by those drafting legislation. He gave the examples of FBT exemptions on child care being available only to businesses large enough to operate the child care centre itself, the proposed changes to the tax treatment of employee share ownership plans (ESOPs), quarantining of use of losses compounded by various tests such as 'continuity of ownership' and 'same business', and the distinction between portfolio and direct investment in the treatment of foreign source income.

8.24 The Committee considers that small businesses should be explicitly taken into account when contemplating changes in the tax legislation. To this end it endorses the need for statistics which relate directly to various measures of size, and for the need to assess the impact of proposed changes. Changes to the tax legislation need to account not only for the impact on taxpayers generally, but also for the differences between key groups. The economies of scale which are available to large businesses which enable them to deal with compliance costs associated with ever increasing complexity of tax law, cannot be assumed to be available to small businesses. To the contrary, the unavailability of economies of scale need to be directly addressed whenever changes are contemplated.

**Recommendation 8.1:**

The Committee recommends that:

- (i) the ATO compile and publish aggregated tax data, arrayed by business size; and
- (ii) changes to tax law preceded by the preparation of small business impact statements prepared after consultation with small business and its representatives through existing fora.

**Conclusion - The Burden of Tax**

8.25 Small businesses face a plethora of tax regulations. Both the combination of many taxes to comply with and the sheer complexity of each tax, frequently results in an overbearing burden of responsibility on small businesses.

8.26 The complexity of tax laws means that many small businesses must either spend an enormous amount of time, in addition to that spent running the business, understanding their obligations under the Tax Act and calculating liability, or pay an accountant to take most of the responsibility for that task. Paying an accountant of course means an additional cost to the business.

8.27 Small business owners are generally concerned about miscalculating their tax obligations, or their accountants miscalculating. If calculations of tax liability are not correct, businesses may suffer. If an error favours a business, a penalty may be imposed by the ATO. If the error favours the ATO, the business loses the use of that money for the period until the error is corrected.

8.28 Taxes are not static. Changes are perpetually made to tax laws in order to accommodate the ever changing business environment, or because of changes to the revenue requirements of government. This means that small business owners must be constantly aware of changes relevant to their businesses to enable them to understand their tax obligations.

8.29 Many small businesses are run by sole traders, families or small partnerships. The effort put in to understanding the tax laws and in to calculating tax liability is considerable. In other words, the economies of scale that benefit a large business, or a group of business operated by the same group or company, cannot be applied to a small business.

8.30 However, the same rates of taxation, and the same compliance costs apply to both small and large businesses. The Committee believes that small businesses are at a considerable disadvantage compared to large businesses with

respect to tax compliance. Given that Australia is characterised by a very high proportion of small businesses, the relative disadvantage to them may be a significant factor inhibiting economic growth. The Committee concludes that it would be worthwhile for governments to consider the conditions faced by small businesses when changes to the taxation law are proposed.

Senator A B Ferguson

Chairman,