16 April 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

TOURISM TASK FORCE SUBMISSION IN RESPONSE TO "A PLATFORM FOR CONSULTATION"

Executive Summary

Major tourism businesses generally favour:

On tax rates:

- **Reducing company tax and capital gains tax rates to 30% or lower** even when purchased through the withdrawal of accelerated depreciation, subject to retention of building amortisation on an economic life basis.
- Elimination of the excess 25% concession for research and development support in favour of a lower company tax rate.
- A common company tax rate and speculative capital gains tax rate, set at the lowest achievable level.
- **A capital gains tax rate that is applied to a sliding share of the capital gain as the period of asset holding increases**. This change would provide an important offset for long term asset retention if cost base indexation were removed.

On depreciation

- **A depreciation regime that reflects the economic life of assets and which has reduced compliance costs. This regime to include an increase in the $300 write-off threshold to $1000 to reduce compliance costs.**
- **Including buildings and structures in a consistent depreciation regime based on economic life, in line with plant and equipment**. This implies that buildings receive depreciation in line with their economic lives based on purchase price.
- **Removal of the depreciation limit on motor vehicles with high business use**, as these vehicles are important business assets for many tourism businesses.

- **Explicit recognition that many forms of landscaping, other than earthworks, like other assets have economic lives**, rather than being a "black hole" cost that is only an offset to capital gain on the land.
- Any reform of depreciation or amortisation concessions to only apply to new or sold assets to avoid major distortions in business values.
- **Treatment of export market development costs, in a similar fashion to the often less risky research and development, a 100% deduction in the year of expenditure.**

<u>In support of long-term investment</u>

- **Abolition of Section 51AD and reform of Division 16D** to encourage private sector provision of infrastructure.
- **Allowance for all long-term projects to issue non-deductible, non-assessable debt instruments –** which provide the equivalent of franking credits to investors.
- **Inclusion in "collective investment vehicles" of widely held infrastructure and property trusts allowing "full flow through taxation" including of tax preferred income.**
- **A determined crack down on the abuse of closely held discretionary and family trusts when used to avoid income tax obligations.**

<u>On fringe benefit taxation</u>

- **Removal of entertainment, car parking and meals from the FBT system to reduce compliance costs**, even if meal entertainment is to be non-deductible.
- **Extending to all remote employers, including tourism and commercial accommodation, the exemption from FBT for staff accommodation** traditionally available to farmers but now promised for miners.

<u>On improving the process of business tax administration</u>

- **Formalised consultative mechanisms for new business tax legislation** with representatives of affected businesses to avoid poorly drafted legislation. In particular, the Government with Ralph Review amendments should issue detailed Consultative Drafts of new legislation.
- **Annual reviews and reports by an independent agency, such as the Productivity Commission, of the compliance burden due to various taxes levied on businesses** and explicit reporting against annual targeted reductions in overall taxation compliance burden.

Tourism industry leaders support comprehensive business tax reform

<u>Background</u>

The Tourism Task Force (TTF) is a private, national, apolitical lobby group representing Chief Executives of the one hundred and fifty major corporations and institutions in Australia's tourism, transport and leisure industries. The TTF is Australia's only national roundtable forum for industry leaders and plays an integral role in the "tourism investment equation". The TTF was established in 1989 to provide tourism investors a political voice in Canberra and around the country.

With the wide range of issues raised in the "Platform for Consultation" document and the varying exposure of TTF Members to these issues it was expected that universal agreement between TTF Members would not be achievable on a number of issues.

For this reason, **the TTF undertook an extensive survey of over 200 Tourism Industry Leaders using Arthur Andersen as the independent collator of the data**. The questionnaire provided to Members is attached for the information of the Committee, along with the findings. It highlights widespread agreement on a range of the "big picture" issues confronting the Government.

Beyond the questions asked in this survey detailing the support for many of our recommendations, our understanding is that nearly all TTF Members would be agreed in strong support for the recommendations of:

- ♦ an increase in the $300 write-off threshold to $1,000 to simplify compliance; and
- ♦ the importance of legislating that export market development expenses be deductible in the year of expenditure.

Support for major reform of the business tax system

The Tourism Task Force welcomes the approach adopted by the Government in 'A New Tax System' for a first principle review of the business tax system.

Australia's business tax system is in urgent need of fundamental revision. **A host of ad hoc patches by successive Governments have led to a system which even few taxation experts understand and that is far too complex for most business people**. The current system imposes significant compliance burdens on all businesses, distorts and delays investment decision-making and is inequitable between industry sectors.

In addition, the tax system has itself become an investment risk factor due to unpredictable changes. For example, recent unpredicted changes potentially impacting on tourism businesses include proposals for:

- ❑ clawing back depreciation concessions received by operations using limited recourse debt (Division 243 in TLAB5/99); and
- ❑ capital gains tax cost base adjustments for traveller accommodation amortisation allowances.

Business people in the tourism sector are calling for a business tax system that is readily understandable, has much lower compliance costs and is set in place for many years.

Sectoral equity in tax reform

It is impractical to completely distinguish second stage tax reform from the first stage reform of indirect taxes that is expected to have significant implications for Australian tourism businesses.

Tourism industry leaders are looking for a more favourable outcome from tax reform Stage 2

Compared to other major sectors of the Australian economy, tourism businesses face larger reductions in demand due to proposed indirect tax reform. Tourism unlike other exports is proposed not to be zero-rated, while tourism's imported competition (outbound travel) unlike the case for other sectors will be GST free.

To date, Australian Governments have been slow to recognise that taxing tourism is taxing a major export industry, at least publicly putting more weight on the naïve view that taxing tourists is taxing non-voters.

In 1997/98, tourism exports amounted to over $16 billion. This is equivalent to the sum of total exports of: the combined sum of the wool, wheat, beef, dairy, sugar and cotton industries. Alternatively, this level of export income is equivalent to the sum of total combined exports of iron ore, alumina, aluminium, crude oil, iron and steel, liquified natural gas and nickel.

Tourist spending was estimated by the Bureau of Tourism Research to have been responsible for just over 1 million jobs in 1995-96, of which over two-thirds were due to direct employment impacts of tourist spending.

Inevitably, a simpler business tax system will require withdrawal of business tax benefits closely held by more long established industry sectors. The opportunity therefore exists for the review of business taxation to somewhat redress over time the current expected unfavourable impact of Government tax reform on the tourism sector.

Support for reduced company and capital gains tax rates purchased through withdrawal of accelerated depreciation and R&D concessions

As noted in of the 'Platform for Consultation':
Accelerated depreciation provides significant benefits to capital intensive industries such as mining and manufacturing while being of little benefit to service industries such as finance, tourism or retailing (see page 118).

However, this statement fails to recognise the major role of depreciation concessions for airlines, hotels and transport companies which are heavily capital intensive businesses. Nevertheless, **most major tourism businesses favour the move to a 30% company tax rate purchased through withdrawal of accelerated depreciation, subject to continuation of building amortisation on an economic life basis.**

Within the Tourism Industry Leaders' Poll (see attachment) **84% of respondents supported the statement that the Government should introduce a 30% company tax rate** funded by the abolition of other business tax concessions, particularly accelerated depreciation.

Similarly, rewards for entrepreneurship are promoted under a lower rate capital gains tax (especially with lower company tax). If a lower capital gains tax rate were purchased by removing indexation and averaging provisions most tourism businesses would be supportive, so long as the capital gains tax system also has reduced compliance costs.

Given the potential for abuse of a capital gains tax rate different to the company tax rate, the Tourism Task Force favours a common rate for company and capital gains set at the lowest level achievable.

Strong support exists for a 30% company tax rate, so long as building amortisation is retained.

Within the Tourism Industry Leaders' Poll (see attachment) **over 76 % of respondents supported the statement that the Government should remove indexation and averaging arrangements for capital gains in favour of reducing the capital gains tax rate to 30%.**

However, removal of indexation of the cost base in calculating capital gains will penalise the long term holding of assets. For this reason, and to encourage longer-term investments it is proposed that Australia adopt the recent UK move to progressively exempt a proportion of the capital gain from tax as the holding term increases. Under this tapering system of capital gains tax, a reducing proportion of realised capital gains are taxable over time.

It is difficult to justify continuing major tax advantages for entrepreneurship in tightly defined research and development (limited to traditional sectors) given that the new wave of prospective innovation is often outside traditional definitions of research and development. **Research and development should be eligible for a 100% rather than 125% tax concession to be treated equitably with other often as risky innovation activities.** Is it seriously argued that the external benefits of defined research and development in highly private activities in the commercial sector commonly warrant an additional 25% tax concession? Where external benefits are important a grant scheme with a controllable cost to Government would presumably provide a better investment of public funds.

Depreciation issues

Tourism businesses call for a tax depreciation regime that reflects the economic life of assets and buildings in use and which ensures low compliance costs.

Also critically important is that the depreciation and amortisation regime for existing assets is continued. Any changes in these areas should only apply to new purchases. Transitional arrangements phased over ten years would still induce unfair major changes in many long lasting asset net present values.

The current exemption for items costing less than $300 (allowing write-off) is a sensible, though inadequate, recognition of the importance of compliance costs. **The $300 threshold should be increased significantly even if this requires a slightly higher company tax rate given the compliance cost savings for reducing the length of asset registers.** The Tourism Task Force considers a $1,000 limit would significantly reduce tax compliance burdens.

A first principle review of depreciation must cut compliance costs and improve equity of industry treatment

The Tourism Task Force favours including buildings and structures in a consistent depreciation regime, based on economic life and comparable to the treatment of plant and equipment. This would imply that buildings receive taxation depreciation in line with their economic lives based on purchase price while full balancing adjustments would apply. This approach appears to offer simplicity and equity advantages despite a small increase in compliance costs as it would require separate valuation of the land and the buildings to allow annual depreciation for the buildings and the land being subject to capital gains tax only on a realisations basis.

This approach would mean that the currently fixed 25 year amortisation period for hotels would need to be determined on a case by case basis. Indeed it is common for major hotels to need significant refurbishment every seven years or so, with more significant modernisation on a less frequent basis. For example, the Regent Hotel in Sydney is about to be withdrawn from the marketplace for an extended period to undergo a massive modernisation.

As noted in the consultation document (on p 782) the tourism industry is an intensive user of vehicles priced above the maximum depreciation limit. The depreciation limit currently is $55,134 and was introduced to constrain the extent of claims of luxury cars as business expenses. However, this is a major distortion to a fair depreciation system that impacts on the tourism industry from hire cars, rental cars, specialised tours and in particular the widespread use of four wheel drive vehicles by regional tourism operators.

Whether or not reforms are introduced to the statutory formula for valuing car fringe benefits **it is appropriate that the depreciation limit**

be removed for high business use vehicles. In line with the recommended treatment of other depreciable items it is essential that decisions about whether a luxury car or four wheel drive is appropriate to the particular business is left to the managers of that business.

Treatment of Black-Hole expenditures

Tourism businesses, particularly resorts have endured the inconsistent treatment of so-called "black hole expenditures". Proposed treatment of landscaping and export market development are important issues within the tourism industry.

Landscaping costs are suggested to be included in the cost base of land and effectively deducted against capital gains tax at the time of sale (p 101). However, this ignores that landscaping costs are often a wasting asset, such that eventually replacement of the asset will be required. Unfortunately, the often-integral role of landscaping in resort development implies that this tax treatment will discourage development particularly in regional areas.

In building a golf course, for example, landscaping costs are critical and few other than base earthworks are one-off expenditures. Greens once built need renewing about every 12 years, few trees last more than 20 years if put in as mature (and expensive) specimens. **Landscaping other than base earthworks is commonly subject to an economic life and the normal economic life approach should be applied** (with the taxpayer determining economic life in association with the ATO).

Equity demands that export market development expenses be handled as sympathetically by the tax system as R&D

The proposal that export market development expenses be deductible at the time they are incurred is obviously more attractive than the alternative proposal of a write-off over a statutory period. The current treatment for similar often similarly risky research and development expenses (ignoring the extra 25% concession) suggests an equity argument in support of **export market development expenses being deductible as they are incurred**.

In the event that the favourable treatment of manufactured exports under indirect tax reform leads to further cuts to the Export Market Development Grant Scheme (EMDGS) it is vital that the unfavourable treatment of tourism exports be at least acknowledged by more generous access to EMDGS.

Treatment of long term investments

During the progressive tightening of public sector budgets over the last twenty years it has often been public investment that has been cut. This infrastructure has often been vital to developing tourism's long term potential. Privatisation of existing enterprises has led to efficiency gains, but the calls for long term public infrastructure investment have typically been left chasing too little available finance.

State Governments have progressively introduced private sector capital to vital road, rail, water and power investments. However, private sector funding of infrastructure has run the gauntlet of regulatory change from the Federal Government designed to limit tax concessions to this type of investment.

A first principles review of the tax system must ensure that worthwhile private infrastructure projects with high capital cost, long construction times and long ramp-up periods before positive cash flow can be financed in Australia – without inappropriate State Government guarantees.

The abolition of section 51AD and the reform of Division 16D should be priority outcomes from the review of business taxation. These provisions have confused and frustrated private infrastructure provision for too long. It is the case that domestic tax-exempts should be able to choose the most appropriate combination of public and private sector provision (and distribution of risks and benefits) without being influenced by tax factors. The Commonwealth's understandable concern over transfer of tax benefits is better handled by an inter-governmental arrangement, without burdening the private sector with obstructionist legislation.

Business tax reform must improve incentives for long term investment

Regional Australia in particular has many potential infrastructure projects where project fundamentals provide an economic but not a financeable standalone project.

More generally, special provisions are warranted to assist projects with long construction periods to help ensure this type of project is fundable by the private sector. Special provisions are warranted whether or not a decision is made that the taxable proportion of realised capital gains should fall over time. With the experience of a number of years with Infrastructure Bonds, it is now practical to expand the availability of private issuance of non-taxable and non-assessable bonds in a manner that will ensure they are not used for tax avoidance.

In the Tourism Industry Leaders' Poll (see attachment) **64% of respondents supported the statement that if the Government decides to tax most trusts as companies, developers of long lasting assets should be able to raise debt, like Municipal Bonds in the US, that pay interest that is not deductible (for the issuer) or assessable (in the hands of recipients).**

The most recent Infrastructure Borrowings Tax Offset Scheme should be recreated in much expanded form without the design limits in terms of eligible activities and ridiculously low funding limit. In particular, these bonds should carry a quasi-franking credit to the extent of the entity tax rate with high marginal taxpayers paying a balancing adjustment.

Entity taxation

There are compelling grounds for including widely held infrastructure and property trusts in the definition of "collective investment vehicles" allowing "flow through taxation". This would allow infrastructure trusts to make equity distributions without having to pay "deferred company tax" further eroding the sensitive cash flow position of projects in their early phases.

In this regard, the TTF welcomes the Treasurer's announcement that collective investment vehicles including property trusts will be excluded from the proposed entity tax regime, and subject to "flow-through taxation" instead.

Infrastructure bonds have had their trial and now should be expanded

In the Tourism Industry Leaders' Poll (see attachment) **58 % of respondents disagreed with the statement that the Government should tax widely held trusts (that invest in infrastructure and property) in the same manner as companies.** Given that a number of our Members are in company structures competing with trust structures it was not surprising that there was also considerable support for the proposition (40%).

It is also proposed that widely held infrastructure and property trusts be allowed to distribute tax preferred income as non-assessable income. These trusts operate as collective investment vehicles, which allow small investors to pool their risks. **It is proposed that individuals and partnerships investing directly will continue to receive the benefit of tax concessions and it is inequitable that smaller investors should not have the same opportunity when investing through trusts.**

International precedent exists for this treatment with the United States (and Canada) recognising the special nature of property trusts by allowing flow through of tax preferred income. Achieving this treatment is particularly important in maintaining foreign investment in Australian property and infrastructure, is vital to future growth in tourism investment and employment.

Without allowing distribution of tax preferred income as non-assessable income, widely held trusts will increasingly retain these earnings rather than pay distributions in order to provide a timing benefit for their investors.

A crack down on family trusts is advocated to restore faith in the equity of the tax system

At the same time, there is a need for the Government to respond to widespread community pressure for a crack down on the use of closely held discretionary trusts to avoid personal income tax liabilities. Avoidance of personal income tax using sophisticated structures particularly damages tax equity and undermines the public's commitment to the tax system. While recognising the need for transitional arrangements for small businesses and farmers, urgent action is required to rule out the worst cases of family and discretionary trust abuse.

A particularly surprising finding from the Tourism Industry Leaders' Poll was the strength of agreement with the statement that "given the widespread concern over the use of discretionary (family) trusts to avoid taxation, a crackdown on discretionary trust abuses be a high priority in tax reform. **That 80% of respondents, many of whom would personally have a family trust, agreed with this statement indicates that senior members of the tourism business community along with the broad community agree that a crackdown on abuses of family trusts is overdue.**

Stamp Duty on transfers or conveyances of business property

This reform was promised in "A New Tax System", but this commitment has been subsequently eroded by the State Premiers. Nevertheless, this reform is overdue and particularly necessary given the encouragement for asset restructuring that follows from other elements of business tax reform, such as entity taxation of closely held trusts. Even on the basis of the current comparison, real property bears a disproportionately high stamp duty impost compared to share transactions (which are set to have stamp duty eliminated).

FBT reform

The TTF supports the inclusion of a review of FBT issues as present arrangements have excessive compliance costs and are inequitable in some cases.

FBT reform is urgent if tax compliance costs are to be addressed

The suggestion to move from fringe benefits being taxable unless excluded from the tax to nominating the particular fringe benefits that are taxable would reduce uncertainty. Similarly, **the proposal to remove entertainment, meals and car parking from FBT promises significant compliance cost savings**. It is not expected that by making meals non-FBTable (while non-deductible) there will be any significant growth in this form of expenditure.

All industries should be able to provide staff housing FBT free

In the Tourism Industry Leaders' Poll 80% of respondents agreed with the statement that the Government should remove car parking, entertainment and meals from the FBT regime, even if this revenue is made up by a one per cent (1%) higher company tax rate.

A continuing inequity following "A New Tax System", is that farming and now mining have FBT exemptions when providing staff accommodation. There is no reason these industries should be the only beneficiaries of this treatment. **All industries within defined remote regions should qualify for FBT exemptions for staff accommodation**.

Much higher costs of construction and operation of staff accommodation are typical for remote resorts. To attract staff, resorts are forced to offer comparatively attractive accommodation, often comparable with guest facilities. Resorts such as Yulara at Uluru and the Queensland islands should have the same opportunity as available to often less remote farming and mining employers. Similarly, often less luxurious staff accommodation in outback traveller accommodation entails an FBT burden. Consultation with major resorts indicates that the cost to the revenue of extending this concession within the tourism industry would be less than $1 million, although the compliance burden savings would be significant.

Administrative Mechanisms

Unfortunately, notwithstanding the ambitious scope of this review it remains the case that ongoing improvements to tax administration processes will be necessary.

Recent experience in relation to the draft taxation legislation (in particular Tax Law Amendment Bills 4 and 5) emphasise the need for more responsive consultative mechanisms in the drafting of new tax law. While this Review and its approach to consultation is a vital development, ongoing consultation between the ATO/Treasury and business groups on more narrowly targeted legislation is essential to avoid bad law.

Critical to lasting business tax reform is a better process for drafting legislation and reducing the compliance burden

In particular, the Government in introducting Ralph Review amendments should issue detailed Consultative Drafts of the new legislation. The current experience with GST legislation highlights the difficulties of rushing into the Parliament with legislation that has not benefited from consultation with key business audiences.

In proposed Division 243 in TLAB 5/99, the Government is introducing an unnecessarily draconian amendment to curtail access to depreciation allowances by taxpayers exploiting limited recourse debt. The better approach appears to be use of debt forgiveness provisions to cater for structured non-repayment of limited non-recourse debt.

Business is calling for a low compliance cost tax system. **A commitment to rolling annual reviews by an independent agency like the Productivity Commission of compliance costs with the tax system should be a feature of the ATO's business tax annual reporting**. These annual reviews should identify the highest compliance cost features of the tax system and make recommendations for reducing compliance costs that ensure an ongoing 10% saving per annum in the compliance burden for business.

Beyond providing this detailed Submission as a public input to your consultations, I welcome the opportunity to discuss its contents with members of the Review team or with Treasury/ATO officials. In either case please contact me on 02 9368 1500.

Finally, I emphasise that the TTF's final position on the package of Ralph Review reforms recommended and the Government response will obviously need to be reassessed as the final form of the business tax package takes shape. To take a hypothetical example, any misguided representation of building amortisation as accelerated depreciation subject to removal would lead to a rethink on support for the move to reduce the corporate tax rate to 30%.

Yours sincerely,

CHRISTOPHER BROWN
Chief Executive

Tourism Industry Leaders' Poll

Please complete the following *Tourism Industry Leaders' Poll,* by ticking your responses where appropriate:

Taxation of Tourism Businesses

1 Should the Government introduce a 30% company tax rate funded by the abolition of other business tax concessions, particularly accelerated depreciation? [accelerated depreciation goes to miners, farmers and to a lesser extent manufacturers]

Yes	84% of responses
No	16% of responses

2 Should the Government remove car parking, entertainment and meals from the Fringe Benefits Tax Regime, even if this revenue is made up by a one per cent (1%) higher company tax rate?

Yes	80% of responses
No	20% of responses

3 Should the Government remove indexation and averaging arrangements for capital gains in favour of reducing the capital gains tax rate to 30%?

Yes	76% of responses
No	22% of responses
No response	2% of responses

4 Should the Government tax widely held trusts (that invest in infrastructure and property) in the same manner as companies?

Yes	40% of responses
No	58% of responses
No response	2% of responses

5 If the Government decides to tax most trusts as companies, do you support developers of long lasting assets being able to raise debt, like Municipal Bond in the US, and paying interest that is not deductible (for the issuer) or assessable (in the hands of recipients)?

Yes	64% of responses
No	28% of responses
No response	8% of responses

6 Given the widespread concern over the use of discretionary (family) trusts to avoid taxation, should a crackdown on discretionary trust abuses be a high priority in tax reform?

Yes	80% of responses
No	16% of responses
No response	4% of responses

Thank you for your co-operation.
Responses will be treated in STRICT CONFIDENCE.
Collection and collation of individual results will be independently managed by Arthur Andersen.