15 April 1999

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

Dear Sir

I am writing, on behalf of the Real Estate Institute of Australia, to make a submission in relation to some of the issues canvassed in the discussion paper “A Platform for Consultation”.

REIA wishes to comment in relation to:

- The taxation of capital gains;
- The taxation of entities;
- The company tax rate and depreciation; and
- Compliance costs for small business.

Before commenting on these areas, however, I wish to provide some general views on the RBT discussion papers and the consultation process to date. Frankly, the discussion papers have not been more than marginally helpful in promoting an informed debate on business taxation issues. Their length, the language used and the very technical nature of much of the content has meant, for many people in business, the need to seek expensive advice on what the words mean or to take the chance that the words mean what you hoped they mean and not something completely different. For those of us in small business, economics often dictate the latter course.

The consultation process has also been disappointing. I have been involved in one small group discussion on the Capital Gains Tax options and in a small business roundtable which Mr Ralph, Mr Allert and a number of the Review team members attended.

While I acknowledge the willingness of the Review to conduct consultations, the very restricted terms of reference under which they are operating and the overlay of ‘revenue neutrality’ in the options put forward, do not engender much hope that any changes which may come from Government consideration of the final recommendations will be anything more than ’robbing Peter to pay Paul’, especially where small business is concerned.

Nevertheless, in the spirit of review and consultation, I offer the following comments on the areas mentioned earlier.

THE TAXATION OF CAPITAL GAINS

Capital gains are not, by their very nature, income but REIA supports taxing those gains when they are realised. However, because they are not inherently income, taxing those gains on an indexed basis is, in our view, a fair treatment of them. REIA has consistently opposed the ever increasing revenue taken from Capital Gains Tax which fails to recognise the speculative nature of some capital gains against those realised from assets held for a reasonable time and purpose. In that regard, REIA has promoted the replacement of CGT by a Speculative Gains Tax at a stepped down rate over 10 years and is pleased to see such a proposal put forward by the RBT as one of the CGT reform options. As a counterpoint however, the Review suggests that indexation and averaging of capital gains might be removed. The Review’s own figures reveal that applying a stepped down rate for CGT and removing indexation would be revenue-neutral and, but for some reduction in the ‘lock-in’ effect inherent in the current system for longer-term investment assets, is hardly worth pursuing.

Under this scenario, those investors who make small capital gains would be real losers while those who make large capital gains will be winners. As usual, most of those small investors are individuals or small businesses.

REIA is also concerned about the discussion in relation to the existing goodwill exemption and in relation to scrip for scrip rollover. In REIA’s view, goodwill remains a significant proportion of the sale value of real estate businesses even after the High Court’s decision in ‘Murry’. The proposal to replace the 50% goodwill exemption with a 20% general exemption on the disposal of small business assets is preposterous. REIA believes that the goodwill exemption should be replaced by a 50% general exemption and that the threshold in this area should be raised to $5million to match the current Div 17A and 17B asset test,

The scrip for scrip rollover proposal, if adopted, would further exacerbate the current horizontally inequitable treatment of business assets. Not only should the proposed relief be extended to all incorporated businesses but also be applied to other transactions involving the upgrading of assets.

THE TAXATION OF ENTITIES

In our view, the case for taxing all entities in the same way that companies are taxed is flawed. The arguments forget that the primary taxing point is the individual taxpayer. We do not have a transaction based taxation system but rather, a terrible hybrid system based on natural persons, entities and transactions. Ultimately, however, the taxpayer is an individual and, even in the company tax system, the dividend imputation system recognises that the tax is ultimately paid by the shareholders who are natural persons.

The preferred approach of the Review seems to be to impose the complicated and inconsistent taxation treatment of companies on other 'entities' that are already recognised by the tax system as doing everything on behalf of their owners with any tax liability falling on those owners, individual tax payers. A more equitable and simpler approach would be to treat companies, for tax purposes, like trusts or partnerships.

REIA recognises, however, the difficulty of applying this to 'widely held companies' and suggests instead, that 'closely held companies', the most common corporate form in small business, should be taxed in the same way as the current treatment applied to closely held trusts.

THE COMPANY TAX RATE AND ACCELERATED DEPRECIATION

The proposal for a company tax rate of 30%, and the proposed income tax cuts in the ANTS document, are welcome in the small business sector. The suggested possible trade-off of accelerated depreciation for a reduced company tax rate is of little concern to small business generally because most small businesses are labour-intensive rather than capital intensive. These proposals taken together, however, do not deliver sufficient reform for the small business sector to prosper. Less than 14% of small businesses are companies, while more than 20% are 'other entities' and over 65% are individual taxpayers. Very few of the options offered in "A Platform for Consultation" provide much relief of the compliance burden faced by small business.

REIA believes that consideration must be given to concessional tax rates for small businesses, that the depreciation provisions should be significantly simplified by the introduction of a simple 25% rate for all items of capital expenditure on a reducing balance basis, with the only variation being a 100% write off for single items of capital expenditure of up to $2000, and that there be no re-introduction of an undistributed profits tax.

COMPLIANCE COSTS FOR SMALL BUSINESS

Recent research by Evans et al shows the inequitable compliance burden placed on small business by the current taxation system compared to big business. Nothing in the ANTS proposals, or the RBT proposals, give much confidence to small business that this burden of compliance costs will be relieved. Indeed, the Council of Small Business Organisations has recently estimated that the compliance cost gap will widen rather than narrow.

Small business supports tax reform but that reform needs to be fundamentally focussed on simplification and equity, where people with similar income should pay similar amounts of tax and that people with higher incomes should pay more tax than others.

REIA is concerned that the RBT proposals pay only lip service to those reform principles. The options are in no way aimed at simplification and their espousing of equitable treatment does not stand up to close scrutiny. All taxpayers should be treated equally and none more equally than others.

Small business has a genuine concern about the unequal compliance burden of the tax system and, by extension, tax related employment costs, such as PAYE costs, superannuation, child support, family allowance, HECS etc. Neither the ANTS proposals nor the RBT discussion papers do much to recognise or relieve this inequity.

CONCLUSION

The work of the RBT is a start but it does not go far enough for small business. Small business represents over 95% of the private sector in Australia. REIA itself represents over 6000 businesses in that 95%. The Review should not focus simply on reforms that favour 5% of the private sector but recognise the inequities for small business in the current system and propose real reforms to benefit all business.

Yours sincerely

Daryl P Smeaton
Chief Executive Officer

Contact Person: Daryl Smeaton, Chief Executive Officer
02/62824277 (ph)
02/62852444 (fax)
daryl.smeaton@reia.asn.au