Response to Ralph Committee Options Paper

Part 1

Lifting the Reform Focus on Employment and Small Business

Introduction

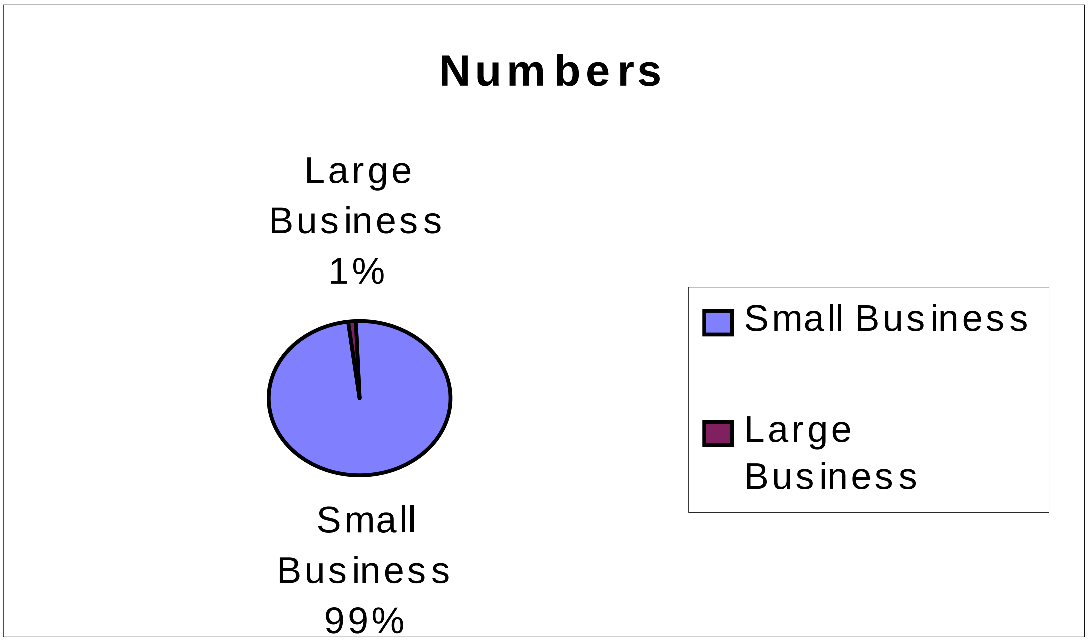
In this response we will address the issues that have been raised by our membership as a result of their study of the paper. Small Business representatives have viewed the business aspects of the paper as being focused on Big Business. Much of the comment that follows deals with issues that the paper does not address but Small Business believes it should.

The terms of reference precluded the committee from dealing with sole traders and partnerships because they will largely benefit from lower tax rates under the ANTS Package. The omission of these businesses from the review ignores the impact that changes to the way business income and deductions are treated will have on them. Since most Small Business is unincorporated this area should not have been excluded from the review.

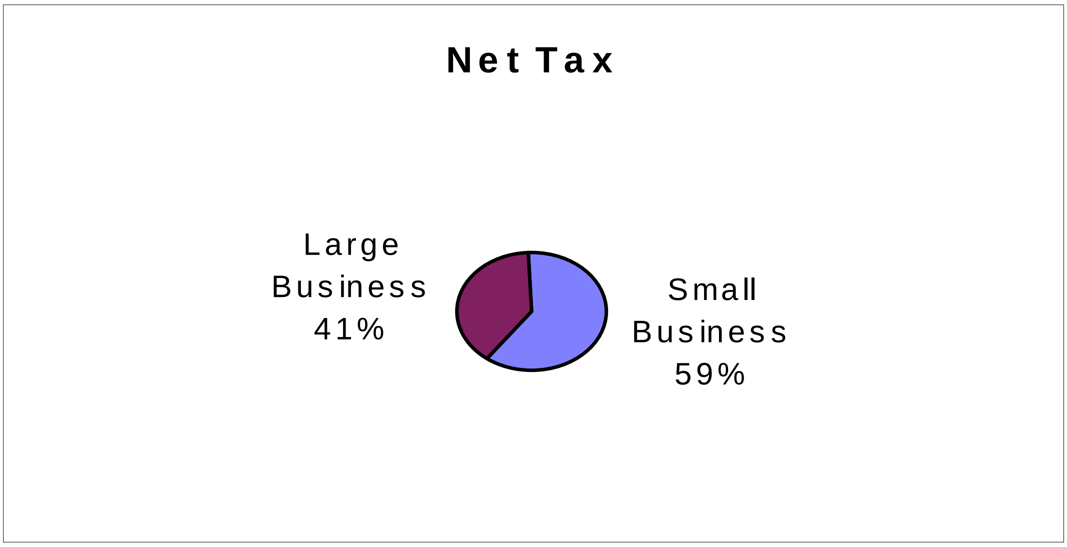
Small Business and the Economy

The contributions made to the economy by Big Business and Small Business are very different and central to COSBOA's argument is the belief that Tax Policy must reflect these differences. The charts below show the percentages by number and net tax of businesses by small and large:

COSBOA Chart 1



COSBOA Chart 2

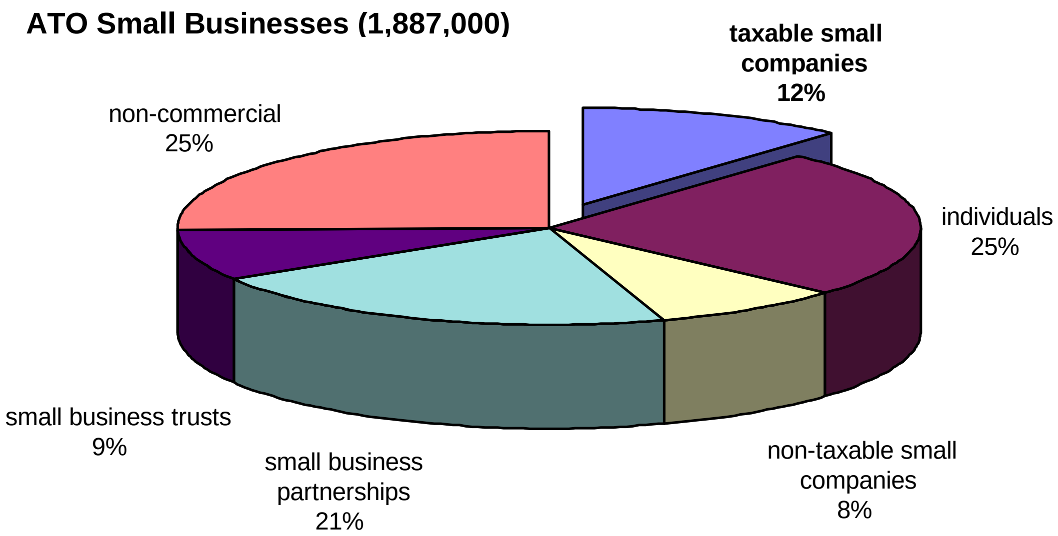


These charts clearly show that by both number and tax contribution Small Business makes up a very significant part of the economy and that its particular concerns cannot be ignored.

The most widely canvassed issue from the review has been the trading of accelerated depreciation for a lower company tax rate. From a Small Business point of view this would have no aggregate beneficial effect for the sector and would significantly advantage larger users of capital in the market place. The following five charts give substance to this view.

COSBOA Chart 3

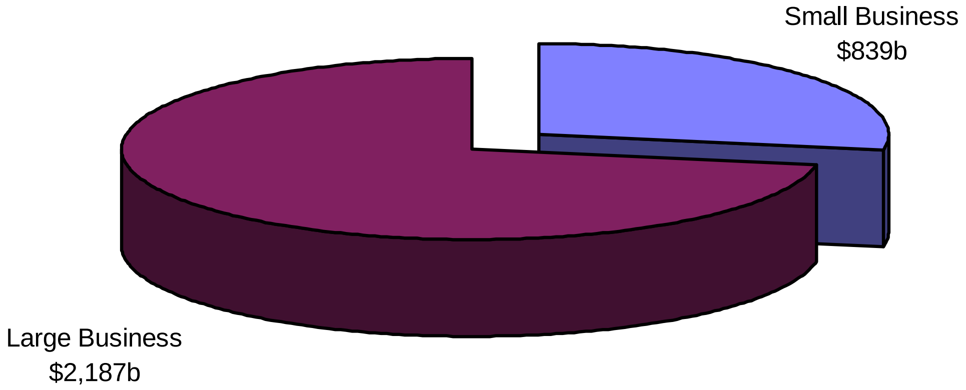
How many small businesses *may* benefit?



COSBOA Chart 4

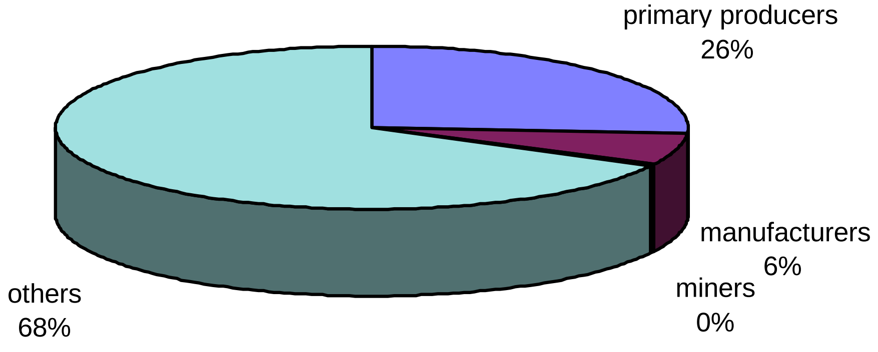
Further, the bulk of small taxable companies hold little capital. The company structure is used legitimately as a device to protect family assets and disperse earnings to employees.

Tax saving from drop in company tax rate to 30%



COSBOA Chart 5

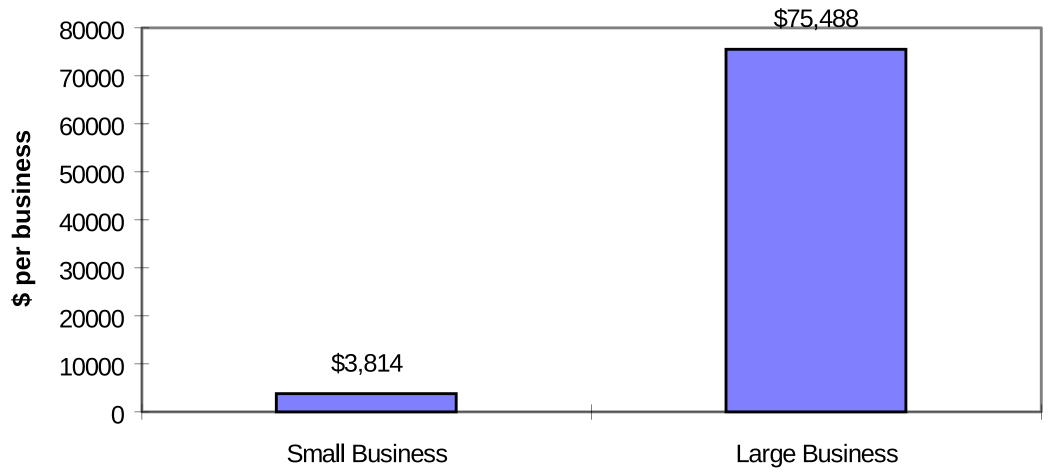
Potential small businesses adversely affected by loss of accelerated depreciation



Unincorporated small business in 3 industries will potentially lose AD and not gain from lower company tax rate

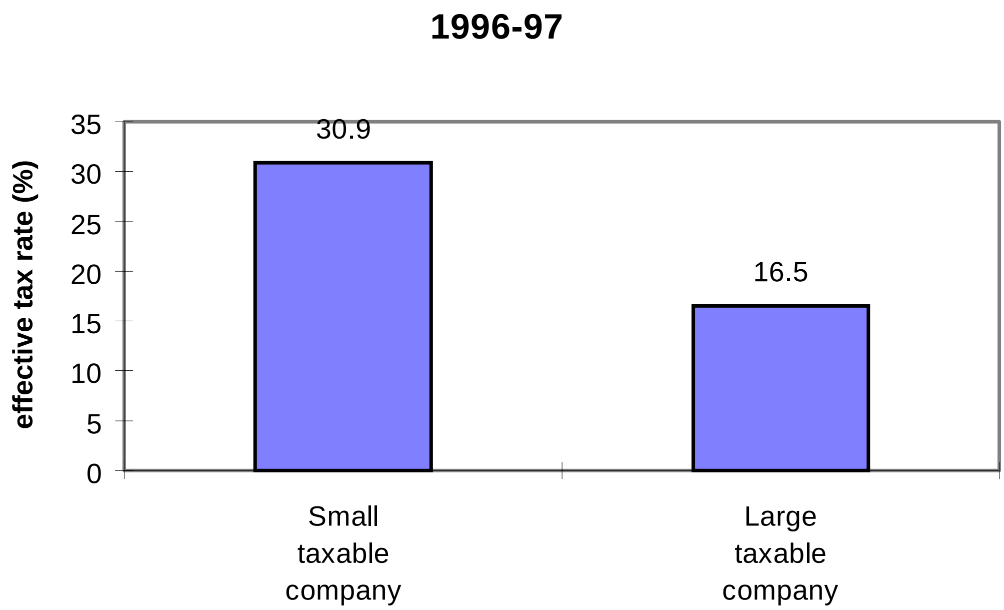
COSBOA Chart 6

Saving per business from drop in company tax rate to 30%



COSBOA Chart 7

Effective company tax rates (1996-97)



(Source of data: ATO Statistics 1996/97)

The points that can be drawn out from these charts are:

- Only 12% of small businesses, i.e. taxable companies, technically benefit from a lower corporate rate, the bulk of these hold little capital.

- The corporate tax saved falls mostly at the Big Business end of the market and represents 10% of tax paid by them, Small Business would save less than 5% of net tax payable by the sector.

- Amongst unincorporated Small Business some 32% would potentially lose access to accelerated depreciation with no benefit from a lower corporate tax rate.

- Tax savings per company would be 40 times greater for Big Business than for Small Business

- Big Business already have lower effective tax rates than Small Business.

Taking all the above factors into account it is COSBOA's strong view that more attention must be given to the implications that the proposed options will have on Small Business than has been given to date.

Tax, Polarisation of Commercial Wealth and Job Creation

The focus of the options paper on Big Business is seen to be driven by wealth creation being the most important issue. It is unfortunate, but true, that most Small Business operators are not in the high income or high wealth group in the community. Indeed many Small Business operators are at the other end of the prosperity chain and would be included in the low income category. Paradoxically it is from this latter sector which most new jobs come, see Chart 8.

The delivery of tax cuts to Big Business proposed by the options paper will most likely lead to a widening of the gap. The tax cuts to be delivered to individuals as a result of the ANTS package are acknowledged, but as we are now seeing from evidence to the Senate inquiry on GST, it is likely that those cuts will be only sufficient to meet increased living costs and are likely to be eroded over time in any event.

COSBOA believes a greater focus should be placed on equity between large capital intensive and small labour intensive firms in the business tax reform process to avoid exacerbating the already existing wealth polarisation within the community.

Unemployment as a Key Objective of Taxation Reform

Unemployment is regarded as the most pressing problem facing Australia today. Although currently moving slowly downwards it is still too high and the electorate remains concerned about the future work prospects of the children.

Jobless revenue growth will not be of long term benefit to Australia!

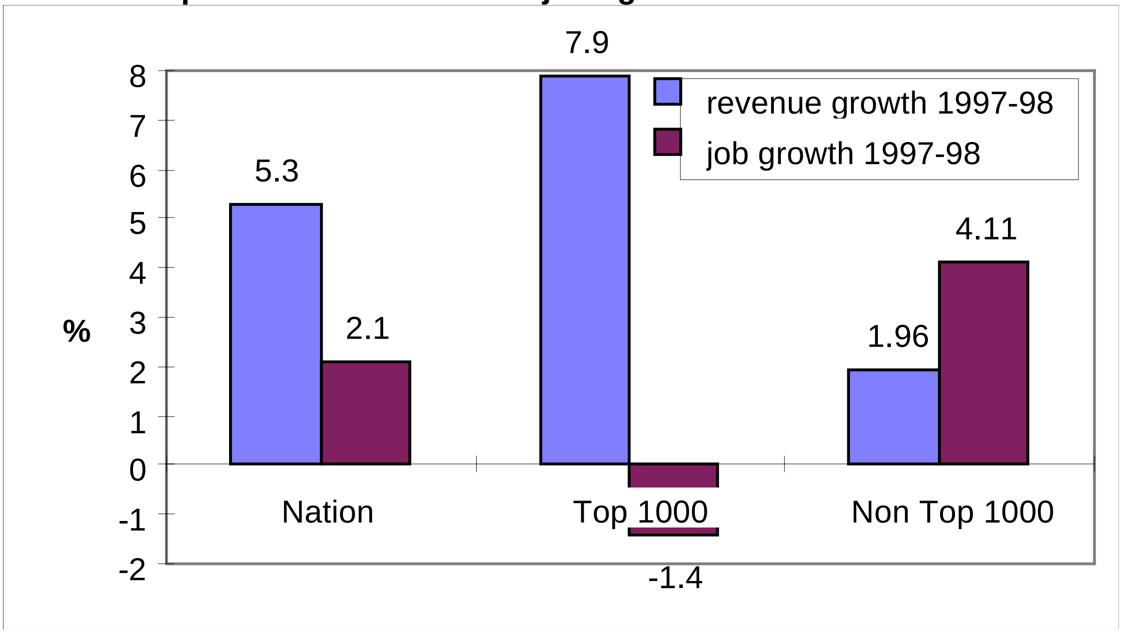
Small Business is the acknowledged job creator in the business community. It is also frequently described by political leaders as the engine room of growth in Australia. However,

nothing in this package appears to be aimed at stimulating Small Business to assist it to grow jobs at a faster rate than it is already.

The following chart illustrates the relationship between national revenue received and jobs created by Big Business compared with Small Business in one twelve month period.

COSBOA Chart 8

Comparison of revenue and jobs growth from 1997 to 1998



From this chart it can be clearly seen that:

- Overall national revenue from 1997 to 1998 grew by 5.3% while the number of jobs increased by 2.1%

- Excluding the top 1,000 companies national revenue growth grew by 1.96% and jobs grew by 4.11%

- Amongst the top 1,000 companies revenue grew by 7.9% and jobs fell by 1.4%

Jobless Growth

The issue for policy makers is whether they want revenue growth without concern for jobs! Big Business will deliver revenue growth but at the expense of jobs; Smaller Business will deliver more moderate revenue growth but accompanied by jobs growth. COSBOA believes that job creation should be a key focus of taxation reform and that the part Small Business is playing in this area must be recognised and further assisted.

Capital Availability for Small Firms

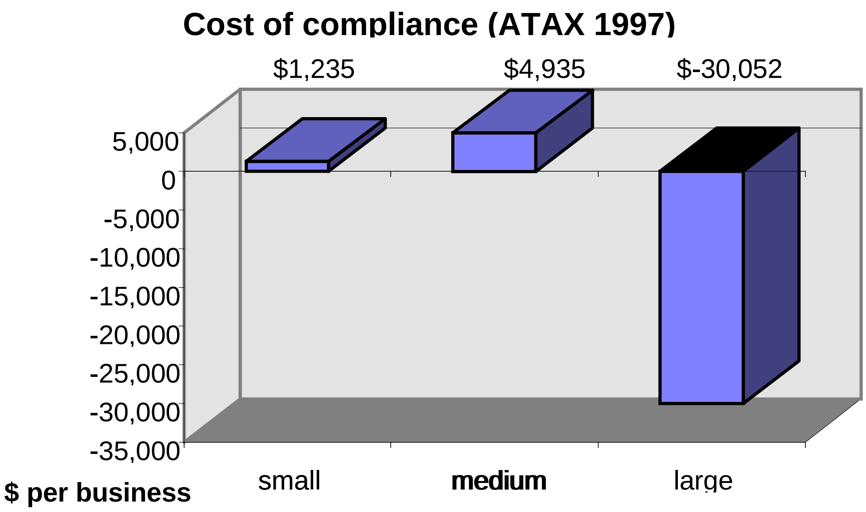
Small Business is frequently in need of capital support. Sources of funding are often limited with onerous conditions attaching to loans. Without question the distribution of capital within business is a central issue in the competitive processes. Taxation reform must not further distort the availability of capital in Australia's small economy. COSBOA would argue that reform should seek to rebalance it.

Cost of Complying and Employing

Costs of complying with taxation laws and the lack of compensation for those costs is one of the most important issues of concern to Small Business today. Study after study has shown that the costs of complying with taxation laws are high and that they fall disproportionately on smaller enterprises. The study by ATAX for the Commissioner of Taxation clearly established that there is a high cost differential between Big Business and Small Business. On average large firms benefit from current tax arrangements by more than $30,000 per year while it costs small and medium firms approximately $1,200 and $5,000 respectively. Studies in other countries have revealed similar results.

The charts below clearly demonstrate the issue.

COSBOA Chart 9



The essential points to be noted about the current costs are:

- Big Business profits hugely from the current tax system while Small Business pays to comply. This is anti-competitive.

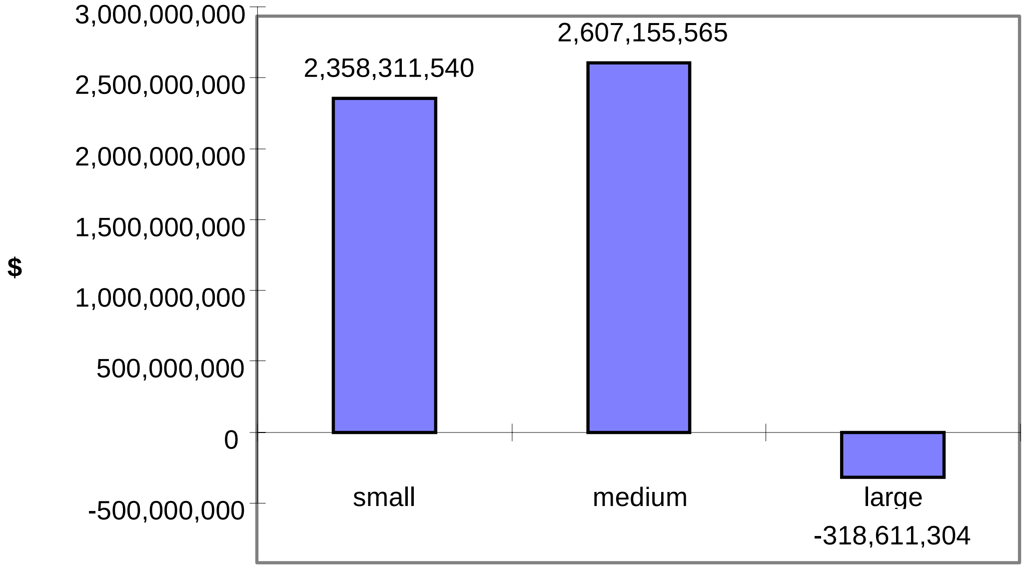
- Small businesses suffer a cost of compliance disadvantage of $31,300 and medium businesses suffer a disadvantage of $35,000

- The aggregate cost to small business of complying with tax laws and associated paper-work is over $2.3 billion and for medium businesses is over $2.6 billion while Big Business, in aggregate, benefits by over $300,000.

- Any transfer of state responsibility and duties of care to the private sector through the tax system is at a cost and this cost falls more heavily on Small Business and particularly labour intense businesses.

COSBOA Chart 10

Where the current costs of compliance fall

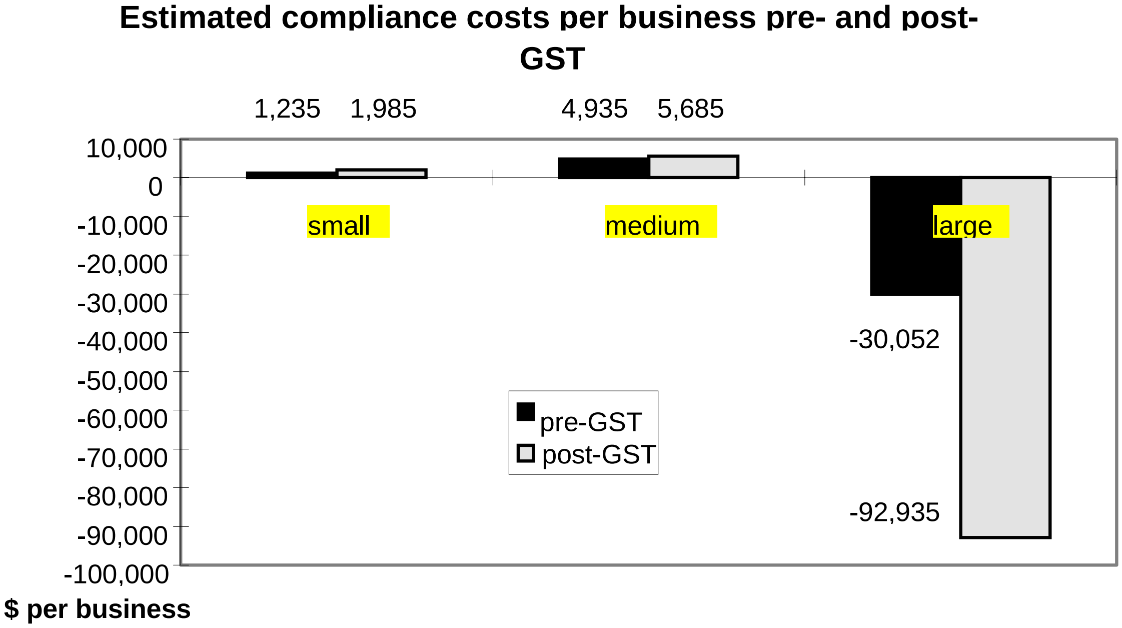


(Source of data: 1998 ATAX Report to Commissioner of Taxation)

Whilst it is not possible for Council to accurately forecast the effect of GST on compliance costs all the overseas evidence and experience points to exacerbation of the current imbalance in costs. Well respected experts in the field of tax compliance cost measurement, including Professors Neil Warren of ATAX (UNSW) and Jeff Pope, have consistently pointed to GST costs falling disproportionately more heavily on Small Business than Big Business.

The following chart demonstrates the impact if each small and medium business spends just $750 (note NZ experience suggests that $1,000 would be closer to the mark) while the overall costs of compliance increase by 25% (this is reasonable given overseas experience).

COSBOA Chart 11



It shows the gap in compliance costs will increase substantially (approaching $100,000 for medium/large comparisons)

(This sort of result is highly likely when you consider that a large retailer with turnover of $1.5 billion per month could earn around $1 million interest each month on the short term money market from GST funds.)

At the press conference releasing the options paper Mr Ralph noted that compliance costs currently were of the order of $8 billion. He inferred that adoption of options in the paper could reduce those costs by as much as 25%. Any objective reading of the paper will conclude that any compliance costs savings will accrue to Big Business and only small or incidental savings, if any, would flow to Small Business. Cutting compliance costs for Big Business is a worthy exercise but only if it is accompanied by more significant cutting of compliance costs suffered by Small Business. The logic at this stage says that the compliance cost gap between Big and Small Business is going to increase rather than decrease as COSBOA and others believe it should.

State Services

During the recent Federal election and since COSBOA has asked that these costs be separated into two distinct areas. We believe both the character of, and the solutions for, these areas are different. In essence we see on the one hand:

- *Costs relating to general tax administration*

and quite separately,

- *costs induced by and through the tax system which relate to the employing and handling of people.*

General Tax Administration

The high transactional costs that some 8-900,000 small firms will bear when collecting tiny components of GST will be particularly relevant here. As this area is centred on economies of scale the proper compensatory measure should be similarly focused.

COSBOA has recommended that a rebate of 10% for collection of taxes be retained by small firms on a reducing scale as tax and/or turnover increases.

Employment Related Costs

Much of the second category of costs carry within them components that have been transferred from the State to employers. These *State Services* include revenue collection, superannuation, child support, medicare, family allowances, unemployment benefits administration and so on. It is COSBOA's strong view that employers should be fully compensated for the *State Services* they perform.

It is an economic fundamental that a free service generates infinite demand

The State must learn to pay for the services it receives free from business.

It is COSBOA's belief that solutions and compensation in this area should be based on more of a per head basis, with a skew towards the smaller firms, particularly for those too small to carry a human resource manager.

Have Fresh Options Been Considered?

The options being canvassed by the committee project little creativity and are clearly framed against the current system. There appears to have been little consideration of options that may offer solutions to many of the problems cited above and in the report, and at the same time more efficiently deal with one of the major issues that the committee has been tasked to address, that is the achievement of tax equity as between different entity types.

In focusing on the taxation of Big Business the existing general framework seems appropriate. However, the taxation of Small Business on the same basis as their larger cousins should not be automatically seen to be the only course. Council believes more imagination is required if the employment contribution of small firms is to be sustained.

To provide some food for thought we give the following examples of different approaches that could be considered in an overall revamp of business tax arrangements. These thoughts are offered with Small Business in mind.

Special rates for small companies

The United Kingdom has gone some way in recognising the needs of small companies by adopting a sliding scale of rates to assist them. The attached brief description of the system (Annexure 1) gives an idea of how it is to operate. Perhaps this sort of arrangement could apply to all small businesses regardless of entity type.

Tax companies as individuals

Most small businesses are operated as sole traders or partnerships, although there is a clear trend to increasing numbers of companies and trusts being formed, mostly for the limited liability protection that these arrangements afford. However, when one stands back from the structure and looks through it one comes to the conclusion that tax should be paid at the individual rate since sole traders, partnerships and trusts are taxed this way under the present system.

This sort of approach would overcome many of the anomalies that currently exist in the company area. For example, companies are the only legal entity which cannot pass on to shareholders distributions which retain the character of the origin of the funds being distributed. They therefore cannot pass on tax-free reserve distributions or the exempt component of sale of goodwill or the indexation components of capital gains.

(These anomalies could be corrected by legislative change but there has been a reluctance to do so to date.)

On the other hand, only companies are allowed concessions such as the 125% Research and Development expenditure deduction. *(There is no obvious reason for this anomaly.)*

Taxing companies as individuals would have the following benefits:

- Remove the tax advantage of one legal entity over others;
- Introduce a sliding scale rates of tax for smaller companies;
- No further payment of tax required on franked dividends (although refunds would be required in appropriate cases);
- Simplicity;
- Preservation of the character of distributable reserves; and
- Same timing of payments as for individuals.

Treat all small businesses as a separate entity for tax purposes

The creation of a special class of business entity using the business number registration arrangements as its basis could be developed to enable smaller companies to avoid the high level of regulation under current company arrangements while still affording the protection of limited liability. Effectively all small businesses would be separate entities and taxed at the entity level. Larger companies would still be required to be registered with the ASIC but all smaller businesses would simply register with the ATO.

COSBOA believes that the prospect of establishing a “close corporation” structure should be re-examined in the context of the Australian Business Number.

Should small business be taxed on accounting profits

The concept of accounting profits is foreign to many small business people, particularly among the start-ups which provide most of the jobs. They are more accustomed to dealing with and managing their cashflow. In the start up stages of business cash is often at a premium with capital expenditure requirements, slow sales, etc. The concept of taxation of small enterprises on the basis of cashflow would appear to offer an alternative basis of taxation that would probably see lower taxation in the formative years but higher levels once the business is established and stabilised.

COSBOA is not advocating any one of these options but rather putting them forward as ideas that should be explored along with others in a more detailed examination of Small Business tax arrangements We feel the needs of Small Business have been a secondary consideration in the current review.

Part 2 Responses to Detailed Issues

We will now comment on specific options in the paper as they apply to Small Business.

30% Company Rate as Against Accelerated Depreciation

In Part 1 of this response we have clearly demonstrated that any lowering of company tax rates will be of most advantage to Big Business with limited gains to Small Business companies and some losses in other areas of the Small Business sector. However, if forced to form a view on a lower company rate in exchange for accelerated depreciation Small Business would favour the lower rate because it would enable retention of profits by those small companies which require funds to expand. It should be noted though that the farm sector, which makes up a substantial part of the unincorporated part of Small Business, is a large potential loser from abolition of accelerated depreciation; the impact on this nationally important group of industries must be carefully considered and given special consideration before final decisions are taken.

Wasting of Assets (Chapter 1)

At a general level, policy formulation in this area should be driven by simplicity and certainty. Small business people must be able to make their day to day business investment decisions against simple criteria that obviates the need for them to have to get their accountant's advice before they proceed. This leads to support of options that:

- Allow depreciation to the person who spent the money;
- Allow depreciation based on the actual value paid for the item. (The limitation to original cost in the case of buildings and structures requires onerous record-keeping and agreement between parties about provision of information concerning previous expenditure that a vendor may not want to disclose. These existing requirements are considered unrealistic.);
- Allow easy calculation without the need to make estimates of future value;
- Allow for self-assessment but with guidance from the Commissioner on rates/effective life for various depreciable items;
- Allow depreciation from the time that expenditure is actually incurred;
- Avoid unnecessary record keeping by allowing immediate write-off of all small otherwise depreciable items. (In this area option 2 is favoured over option 1 but

COSBOA believes that the current $300 limit should be increased to $1,000 or higher and that any total limit needs to be such as to make the upward move on individual items meaningful.)

- Enables full write-off of depreciable items when they reach a low value. (COSBOA would see this amount as being the same as that which would apply to the immediate write-off for small items.)

- Retains the balancing charge arrangements where depreciable assets are being replaced;

- Does not require onerous market valuations to be obtained of many relatively small items when they are converted to other uses.

In relation to the *blackhole expenditure* discussion on pages 100 and 101 COSBOA supports the general notion underlying the possible treatments outlined. The way we would express this is that all expenditure incurred in carrying on business should be deductible regardless of whether it is capital and whether it ultimately generates income. The reality is that it is the fine distinctions made regarding *capital versus revenue expenditure* and whether it is *income generating expenditure* that cause the technical disputes between the Commissioner and taxpayers that should not occur. The law should recognise that business spends money for a variety of purposes that it sees as appropriate to its well-being and it should treat this expenditure as deductible either immediately or over time.

Trading stock (Chapter 3)

Simplicity and not taxing unrealised gains must be key issues driving policy in this area. Whilst accounting principles are necessary for reporting by those enterprises which raise funds from the public it does not make them automatically right as the basis for taxing small firms.

Bringing trading stock to account at net realisable value would entail annual valuations of stock and could result in bringing unrealised gains to account. Neither outcome is desirable for small business.

Option 3 which allows taxpayers to select one of three methods is the favoured option from a small business point of view.

The discussion in relation to spares and consumables, standing crops and partly completed contracts raises significant cashflow concerns if current practices are varied to ones which bring to account money which has been spent and will not be recovered, or income which is not certain. In addition small firms do not need additional costs of regularly obtaining valuations placed on them.

Goodwill (Chapter 4)

The value of goodwill depends on a range of factors that include such things as brand identity, location, service levels, employee commitment, and so on. The value of goodwill does not stand still. Indeed we would argue that the value of purchased goodwill will almost invariably decline over time and be replaced by the goodwill generated by the new owners of a business. In some cases the new owners may increase the original value and in others they may not be able to sustain the previous level.

Whilst the discussion paper notes that to allow deductions for amortised goodwill should be offset by bringing annual increases to account the impracticality of doing so is acknowledged. We agree that any attempt to value goodwill outside a sale would be error-prone and lead to unnecessary dispute.

From a small business point of view we would favour an option that allowed amortisation of goodwill over a period, say five years, with a bringing to account at sale under the capital gains tax arrangements. This treatment more closely follows the cashflow, that is deductions are allowed closer to when the money is spent (and probably more in line with the decline in value of the asset purchased) and tax will be paid when the asset realised.

If changes of this nature were not to be pursued the small business community would see at the very least retention of the 50% exemption and the $500,000 roll-over relief.

Leases (Chapters 8 and 9)

Much of the discussion here relates to complex arrangements that the vast majority of small firms are not involved in. Having said that we would strongly urge that where tax advantages are being gained by a few at the expense of others that efficient ways to close down those advantages be found; but not to the detriment of all.

For most small enterprises leasing is a convenient and efficient way to acquire the use of plant, equipment and motor vehicles because it avoids large outlays of funds, simplifies bookkeeping and gains immediate tax deductions for actual expenditure. It would be unfortunate if these arrangements were to be altered for all business to close down loopholes that would appear to be used only by much larger enterprises.

Option 2 (page 248) which appears to be designed to deal with abuses of tax preferences but which allows significant exclusions would be appropriate so long as the exclusions were broad enough to cover the types of leasing arrangements found in typical small firms.

Capital Gains Tax (Chapters 11 to 14)

Policy considerations in this area must again be guided by simplicity, certainty and equity and in addition they must take into account the special situation of small business people. Current policy in this area was developed to support investment in small enterprises in recognition of its job creation record and potential. It also recognised that for most small business proprietors the value they can build up in their business forms the basis of their retirement pool of funds. Consequently we believe that policy formation in this area must recognise this and treat it accordingly.

Asset accretion by small business operators takes place over time and in different ways. In some cases a small business person will start a business, grow it and stay with it until retirement; in other cases a small business person may move from one business to another over several years improving each as time goes by until retirement; and yet another scenario would see a business person adding new businesses to his/her business interests and divesting some as opportunities arise. In all cases the business person is building a pool of capital that will be the foundation of retirement income.

Current policy has been developed taking some of the above into account, recognising the jobs growth provided by the sector and acknowledging the favourable treatment that employees have been accorded in the superannuation area. All of these factors still exist and we would argue that all capital gains in the small business area should be given favourable taxation treatment.

Taking the above points into account would suggest that good policy on capital gains would have the following features:

- Record keeping requirements would be minimal,

- Realised losses and gains would be treated in a similar manner when they occur, and

- Capital gains realised upon the sale of small firms would be treated in a similar manner to the retirement savings of salary and wage earners.

We will now address some of the specific options raised in the paper.

The proposed $1,000 tax-free threshold for capital gains for individuals looks attractive but it would be of limited real benefit to small business people whose capital gains generally relate to the sale of business assets. The small business community would prefer to see any revenue impact from this measure directed to areas where it would be more beneficial to the economy in general. It should also be noted that there would be little saved in the area of record keeping as records must still be kept in order to determine if a gain, and to what extent, has been made.

Both the capped rate and the stepped rate proposals appear to have appeal in that they recognise the special nature of capital gains. However, as observed the problems of distinguishing between capital and revenue gains will remain and will cause complexity and dispute. The attraction of the stepped rate with a zero end point would enable records for long-held items to be eliminated and this would be a significant advantage. However, unless that point was reached within a reasonable time the advantage would be minimal.

On balance, and subject to comments elsewhere, it would appear that a lower rate for capital gains would be the better option because of its relative simplicity.

In relation to the discussion on mergers COSBOA notes that many of the mergers that have occurred over recent years have lead to greater concentration of ownership in particular industries, with consequent loss of employment and squeezing of small business. This is particular so in retail, media and petrol industries. We do not see any benefit to the community in general by giving more favourable treatment to capital gains made in the course of a merger over gains made by a small business person upon the sale of his/her business. Whilst this view is at odds with our general view that only realised gains should be taxed this is an area where the change being proposed would assist Big Business mergers which generally work against Small Business.

At page 301 it is suggested that the current 50% gain on goodwill exemption on the sale of a business be replaced with a general 20% exemption on all capital gains up to $5 million. It is difficult to make a choice between these options because data to support one over another is simply not available. The certainty that the suggested option provides makes this option attractive as it would solve some of the problems that occur when components of businesses are being valued at the time of sale. However, it may be that 20% is too low and it should be set at a higher level, say 30 or 40%.

In relation to CGT indexing arrangements there is no doubt that the calculations are complex particularly where capital items have been subject to change over the years as often is the case with small business assets. However, the arrangements do recognise the time change in the value of money, and this is particularly important where inflation is high. Whilst inflation is low at present this cannot be assumed for the long term. Removing the indexation arrangements would remove the calculation but record keeping requirements would not be changed. Nevertheless, if other changes occurred that simplified CGT arrangements then indexation could be a worth-while trade-off.

Whilst the current averaging arrangements may produce *inappropriate results* in some cases we would not automatically favour their removal as they were introduced in recognition of the inappropriateness of one-off capital gains moving taxpayers to higher marginal rates in a year. However, if a capped rate of tax applied to capital gains then the need for averaging would not be so important. Changing the average arrangements would depend on the overall fairness of the package of changes to capital gains tax.

In relation to the current arrangements quarantining capital losses until they can be offset against a realised capital gain the obvious observation is that they lack symmetry with the taxing of gains as they occur. An option not canvassed is the immediate allowance of the losses as they occur. This would be favoured by the small business sector. Of the other options put forward option 4 would be favoured as it would recognise immediately the types of capital losses more often suffered by small business.

It is clear that the current arrangements concerning partnerships and the disposal of assets is overly complex and would not be understood by the vast majority of partners in small enterprises. Option 2 which seeks to simplify the arrangements has attractions and should be further explored.

Distribution Definition in an Entity Regime (Chapter 18)

At a general level we would see the broad definition proposed under option 1 as being more appropriate than retaining the existing complex arrangements that require distinctions between benefits. This is consistent with our support for the proposed reform of fringe benefits tax arrangements which would see the onus for this tax passing back to the employee.

Consistent Treatment of Entity Income (Chapter 21)

At a level of principle COSBOA has no general objection to the notion of taxing business entities in the same way regardless of the entity type. However, consistent with earlier comments there is a case for treating small enterprises in a different way to larger ones, but with consistency amongst that group.

Trusts and the Entity Regime (Chapter 22)

Whilst COSBOA has no argument with the general principle of taxing similar businesses in the same way regardless of the entity through which they operate the observation has to be made that the desire to treat trusts the same as companies seems to be driven more by the dubious tax practices of certain high-profile individuals rather than for good business reasons. Great care needs to be taken to ensure that the validity of trusts as a legitimate vehicle is not overlooked.

COSBOA also notes that there appears to be of the order of 180,000 trusts which derive business income in the small business sector (ATO Taxation Statistics 1996/97). Much more detail than is currently available would be needed to understand the implications of the proposal on these small businesses. If these trusts needed to be altered in anyway the costs of unraveling arrangements for this group would be very significant.

Tax Avoidance

COSBOA does not support general anti-avoidance provisions which can be invoked at the Commissioner's discretion. Tax laws need to be certain. Small business operators need to be able to make financial decisions affecting their business without the fear that the Commissioner may exercise a discretion to declare a particular set of transactions tax avoidance. The law needs to clearly say what is acceptable and what is not. We are particularly concerned about the type of anti-avoidance arrangements in the GST Bill which , if passed, would give the Commissioner extraordinary powers.

Pooled Superannuation Funds (Chapter 36)

COSBOA believes that Pooled Superannuation Funds (PSTs) should continue to be taxed at the 15% rate under current arrangements. The introduction of a refund system of the nature proposed in chapter 15 would create some obvious extra compliance costs that would ultimately lead to higher management fees and a reduced return from these funds.

PSTs provide a significant source of funds that could assist in the financing of venture capital requirements and small and medium enterprises. We note that it is generally difficult to distinguish between venture capital and small/medium enterprise funding requirements. As PSTs are entitled to concessional tax treatment COSBOA believes that they should be required to invest a proportion of their funds in small and medium enterprises in order to qualify for the concession.

Fringe Benefits Tax (Chapter 38)

The current fringe benefits tax arrangements are clearly in need of an overhaul. The rules and the costs of complying with those rules belong to another era. It is interesting to reflect on the history of FBT.

- Before FBT was introduced employees were liable to pay tax on the benefits they received.
- It was introduced because of the administrative difficulties of determining *the value to the employee* of a benefit.
- It was levied at the employer level to avoid the costs of calculating separately the benefits each employee received.
- Recent changes announced require that the benefit each employee receives be separately shown on group certificates.
- The committee proposes that employees be liable for the tax on their fringe benefits.

Almost full circle has been turned.

At a level of principle there can be little argument that individuals should pay tax on the income that belongs to them. This view supports the thrust of the committee's main recommendation in this area to tax these benefits in the hands of employees. The recent changes mentioned above mean that this would now add little to compliance costs. Indeed it is likely that many firms would cash-out the benefits where appropriate rather than continue to have to incur compliance costs to monitor them.

The report has identified two areas that cause most concern with business. Entertainment and car-parking fringe benefits.

Entertainment fringe benefits arrangements are a nightmare and it is likely that the level of non-compliance is high because the rules that must be observed are simply too detailed for most to be really able to follow. On the other hand it should be noted that business views entertaining as a legitimate business activity and a return to the pre-1995 treatment would not be appropriate.

In relation to car-parking business regards it as a nonsense to treat this as a fringe benefit. For most car-parking arrangements are not offered to employees for their monetary value but rather for other reasons, for example the space is available and would be wasted if not used by employees, it enables employees to get to work more reliably, it is a sign of goodwill towards employees, and so on. The small business community has never regarded car-parking fringe benefits as legitimate to tax.

Changes to fringe benefit tax arrangements for FBT exempt and rebateable organisations will clearly provide political difficulties if employees are to be taxed directly on their benefits. It is no doubt true that cash salaries in these organisations have been able to be kept below market levels whilst still being able to obtain and appropriately remunerate staff. Any sudden change in this area would have severe adverse effects on many organisations and this would have to be compensated directly by government. It should be noted that many of these organisations are ones the government relies upon in a number of ways, for example charitable, religious and health bodies provide valuable community services that could be severely impaired if effective funding was decreased. Similarly industry bodies provide valuable community and government services through their activities. Sudden changes in remuneration arrangements would disrupt these services. COSBOA would support direct compensation arrangements to ensure that services are not disrupted.