AJ & PA McBRIDE PTY LTD
PASTORALISTS & GRAZIERS

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

24 July 2015

Dear Taskforce,

RE: McBride submission to taskforce

The board of AJ & PA McBride Pty Ltd submits the attached document to the Tax White Paper taskforce as a scope of the issues that the company believes should be covered by the white paper process from a corporate agricultural point of view.

I would also refer the taskforce to previous submissions made by AJ & PA McBride Pty Ltd to the federal government's agricultural competitiveness white paper, and the South Australian government's tax review process, which are both publically available.

If there are any questions in relation to this submission, please contact the Secretary.

This submission is not confidential.

Yours faithfully,

N J Wessling

Nathan Wessling
Chief Financial Officer / Company Secretary
AJ & PA McBride Pty Ltd

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1.0 Preamble

AJ & PA McBride Pty Ltd (the *Company*) is a family owned business of Pastoralists and Graziers formed in 1920. The company is one of the country's largest wool producers, shearing in excess of 200,000 merino sheep across eight properties in South Australia covering more than one million hectares. Whilst predominantly sheep and wool focused, the company produces beef cattle and has investments in viticulture and citrus, as well as a portion of off farm commercial property.

A number of the McBride family are also pastoralists, graziers and viticulturists in their own right, with shareholders also owning at least ten additional farming properties. The views expressed in this document are representative of management and board of the company, and not necessarily those of the shareholders or wider family.

The company has previously made submissions to the agricultural competiveness white paper process, as well as the South Australian government's 2015 taxation review. Taxation matters raised in those submissions that are relevant to this white paper process have been summarised in this submission.

The company notes that some outstanding submissions have been made already, and we would draw the task force's attention to the Business SA paper in particular. As such, this submission will focus on the company's specific area of concern – being corporate agribusiness.

1.1 McBride's taxation burden

An analysis by the company of taxation and payments made to all levels of government showed that, in respect of the 2014 financial year $1.56m[1] was paid. This represents around 55% of the income before these payments, comprising Local: 10.3%; State: 17.0%; and Federal: 27.4%. To be clear, despite agricultural concessions on many taxes and payments, over half of the company's net revenue was paid to government. In addition, it is estimated that the business spends around two hundred hours in the assessment and disbursements of these payments.

1.2 Reform principles

The company applauds the government for approaching taxation reform in a measured, comprehensive and consultative manner. The discussion paper has noted the purposes behind the process, being raising sufficient revenue, reducing complexity, reducing the economic cost of taxation, improving fairness and ensuring global competitiveness.

Although the conversation into raising more revenue has commenced, this tax review should not be focussed on this matter. Rather, it is important that only sufficient revenue is raised in order that a structurally balanced budget is maintained. Whilst noting that there are significant [bi-partisan] forward spending commitments such as the national disability insurance scheme; and the millennium development goals, the focus on this tax review should be about raising revenue smarter. For this reason, the company supports measures that are broad-based, with few exceptions such as consumption and income taxes.

[1] Not including agricultural levies ($200,000) and conveyancing duties ($589,000)

The company notes a taxation fundamental whereby the burden of taxation ultimately falls to individuals, rather than corporate entities. In Australia, this manifests itself in that all taxes are either themselves tax deductible (e.g. rates, levies and fringe benefits taxes); or generate imputation credits, which represents a timing difference between when the tax is paid by the corporate entity, and when it becomes assessable by an individual. In light of calls for the dividend imputation scheme to be discontinued, it is important that any suggested changes to this mechanism do not lead to double taxation, or the fundamental burden of tax being shifted.

1.3 Federation Arrangements

A feature of the federation taxation and payments system is the twin concepts of horizontal fiscal equalisation, and vertical fiscal imbalance. Horizontal fiscal equalisation is required between states in order to preserve some form of equality of service and infrastructure over the federation. States do not have currency or interest rate levers to encourage investment or expenditure and are therefore left with internally generated state taxes; or equalised transfer payments from the federal government.

Internally generated state taxes in Australia are generally unattractive, particularly when compared with the efficient and progressive taxes at federal level. Despite a number of poor quality taxes being removed in 2000 as part of the GST rollout, state government taxes are regressive; inefficient; and undesirable. For this submission 'undesirable' refers to the fact that taxes are levied on 'goods' – items that are beneficial to the economy such as insurance and employment – as opposed to taxing 'bads' such as pollution and gambling.

The *'Australia's Future Tax System'* report noted that of the identified 125 taxes, just ten represent ninety percent of the revenue raised. It is clear that the federal taxation system is preferred to state systems because they have more efficient taxes, such as income tax and GST, but also because it removes the potential for jurisdictional tax wars. Whilst vertical fiscal imbalance is more pronounced in Australia than other federal systems, it should be accepted that this imbalance exists and is a desirable trait of federation, as the federal government is more effective at collecting taxes and there are benefits to having standardised taxation regimes throughout the country. It is recommended that federal taxes (such as GST) be increased in order that less efficient state taxes may be abolished and that states concentrate on service delivery, rather than revenue raising. It is generally accepted that states have a competitive advantage over the commonwealth when delivering services due to reduced wastage through administration.

Correcting the vertical imbalance by transferring some taxation measures to states (e.g. a state based income tax) will inevitably lead to a "race to the bottom" for jurisdictions to attract investment and by entities profit shifting to the lowest taxing state. As a South Australian domiciled company, we do not believe that it is possible for South Australia to win a tax war with other states due to:

- The vast size of the state, with relatively small population;
- The need to provide services commensurate with other jurisdictions, but without the population to provide economies of scale;
- The increasing age of the population in this state compared with others which results in lower contributions from taxes, but a greater reliance on state provided resources, such as health; and

- The lack of non-taxation revenue, such as royalties and dividends on electricity infrastructure etc.

It is arguable that part of the cause of the financial instability in the Eurozone is due to having a common currency with no real horizontal fiscal equalisation mechanism. For these reasons, the company suggests that the existing horizontal fiscal equalisation arrangements must be maintained and suggestions from other jurisdictions, such as the payment of GST transfer payments on a per-capita basis, should be rejected. Additionally, it is recommended that vertical fiscal balance be extended with the abolition of further state taxes in exchange for a measured increase in the goods and services tax.

2.0 Corporate tax

2.1 Dividend imputation

The imputation credits scheme was introduced as a measure to avoid double taxation on dividends. Therefore, the balance of a company's franking account represents the timing difference between the taxation of the company, and the ultimate taxpayer – the shareholder. Or, in other words the franking account represents prepaid taxation and is an interest free loan given to the ATO by shareholders. The discussion paper mounts the argument that the imputation system may be outdated in a globalised economy and is complex to administer. The company sees the inherent benefit of the imputation system as a measure to avoid double taxation. Any removal of dividend imputation would have to address how double taxation would be avoided – such as making dividends tax free in the hands of individuals, or having discounted tax rates for 'un-earned' income (i.e. if company tax and dividends were both taxed at 20%, the overall tax would be 36% - a benefit to individuals on the top tax bracket, but a detriment to low wealth individuals and superannuation funds). Dividend imputation makes domestic equities more attractive to Australian capital which, in a capital constrained country such as Australia, is a desirable trait.

2.2 Dividend imputation and agribusiness

The returns from agriculture generally have a higher capital growth component (when compared with earnings) than other industries. Additionally, there are significant capital requirements (e.g. property improvements) which mean that the cash return from agriculture is well below the accounting returns. This is evidenced by the discount to net tangible assets value for publically listed agricultural companies. One consequence of this is an ever expanding franking account as dividends paid are well below taxable profit. One way to incentivise investment in agriculture by the community would be to allow for these franking credits to be streamed to investors at a higher rate than the company tax rate, for example to allow the franking rate to be increased to the top marginal tax rate or above. The benefit of this would be to allow higher wealth individuals to invest in agriculture and close the looming capital gap. Given that the government has allowed small business to pay tax at 28.5% whilst still paying franked dividends at 30%, the tax/franking percentage has already been decoupled.

2.3 Company tax rate

As has been alluded to above, the company sees corporate taxation as a prepaid taxation asset for an individual. For this reason, there does not appear to be any particular benefit to a reduction in the corporate tax rate, apart from our global competiveness. Over the long run, a reduction in a corporate tax rate will have no net taxation reduction from Australian residents, but the reduction in the rate paid by overseas investment may result in increased investment in Australian business which could generate increased taxation revenue due to increased economic activity and/or capital gains tax.

2.4 Capital Gains Tax

Capital gains tax was introduced in 1985 to even up the taxation treatment of various forms of investment (equities vs interest) as well as to make the tax treatment between active income (labour) similar to passive income (investment). At this time the cost base of a capital gain was indexed by CPI to ensure that investors were not taxed on inflation, but on real gains. When the Howard/Costello government introduced the 50% capital gains general discount and abolished indexation, this somewhat reduced the complexity of the capital gains taxation regime, however it reversed the equity of the tax in both directions: Passive investment income is being taxed at half the rate of active income; and companies, which are not eligible for the general discount are being taxed on inflation when a CGT event occurs. The company believes that the entity that holds an investment should not necessarily alter the taxation treatment of a capital gain, and accordingly, the CGT general discount should be extended to corporate entities, or alternatively a capital gain should be able to be "passed through" to shareholders so that they can receive the general discount. A third option would be to re-commence indexation for entities not eligible for the general discount.

2.5 Corporate structure

The complexity that exists in the Australian taxation system is in part due to the way that different entities are taxed based on their structure. This complexity has been increased since the May budget with small businesses being taxed in a different manner than large businesses. The difficulty that arises with the small business tax concessions is determining the line that is drawn that determines a small business from a medium or large one. Effectively there are three methods: number of employees; profit; or turnover. The government has selected the latter definition as the other two methods are easier to manipulate, however there remains issues with this definition, for example high turnover, low margin businesses (such as farm machinery dealers) who are in all respects a small business apart from their turnover. A second issue with small business tax treatment is when the threshold is breached, the increase in tax is not gradual, but rather an immediate jump in taxation. This may result in shut downs or deferring of investment to ensure that the entity remains below the threshold. For these reasons, the company recommends that all corporate entities are taxed at the same rate. The company would also like the task force to model the effect of taxing all non-labour derived income at a flat rate, irrespective of the entity (partnership, company, individual, discretionary or unit trust) – if this were implemented, not only would dividend imputation become redundant, but also the complexity of implementing tax minimisation structures would be eliminated.

3.0 Agriculture

This section summarises taxation issues raised in McBride's submission to the agricultural competitiveness white paper.

3.1 Farm Management Deposits

The Farm Management Deposit Scheme is a policy designed for non-corporate primary producers that recognises the vagaries of the agricultural income cycle. There is some merit to the retention or expansion of the FMD scheme as it encourages family farmers to save during times of boom. The company notes significant reforms to the FMD scheme were announced in the agricultural competitiveness white paper, such as an increase in the FMD cap, and the ability to use a deposit to offset loans. There still remain some concerns with the scheme though:

- The FMD is only available to farmers with a non-primary production income of less than $100,000. One of the best methods that famers can use in succession planning and in drought mitigation is to diversify their risk by acquiring off-farm assets. Having a cap of this size discourages off farm investment.
- The FMD rules state that the deposit needs to be maintained for at least a year to be eligible for the tax concession. However, this does not assist with farmers who have a poor year immediately after a good year.

The company makes the suggestion that the government could consider using the Reserve Bank as an Authorised Deposit Institution for the purposes of FMDs. The rationale here is that whilst the government foregoes the taxation revenue from monies deposited into an FMD, the government will still have the use of the money if it is deposited at the RBA.

3.2 PAYG and irregular flows of income

The seasonality of income is an aspect of agriculture that sets the industry apart from others. The majority of income from agriculture generally occurs in one quarter, corresponding to the harvest of the product. Although this phenomenon is not unique to agriculture, other industries, for example retail, generally get *some* income whereas in agriculture there are some periods where no income is received for months at a time – even for businesses as large as McBride. The company recognises the primary production exemption from PAYG instalments in the first two quarters of the financial year and applauds the government for this step. Given that these quarters generally result in a BAS refund, it is suggested that an estimate of the refund, based on previous year's returns, might be paid in advance rather than in arrears in a quarterly BAS.

3.3 CGT exemption for succession planning

Family farming is the backbone of Australian agriculture and any succession planning regarding agricultural land and assets should be encouraged and incentivised, rather than penalised by government. Therefore, the transfer of land from parent to child should not be considered a CGT event, nor should it attract stamp duty, even if the parent is still alive and relatively young.

3.4 Wine Equalisation Tax and wine producers' rebate

The company notes that a separate discussion paper on the Wine Equalisation Tax is being prepared in the forthcoming months and at this stage does not advocate for any changes in this matter. However, the company is concerned that the wine producers rebate is available to the subsidiaries of large corporate retailers; particularly the anecdotal evidence that multiples of the cap are available due to the business structure of the retailers. It is recommended that the WPR legislation be reviewed so that (a) the ultimate parent company can only receive one wine producers rebate cap for the entire group's controlled entities; and (b) a possible scale back of the wine producers' rebate be introduced when sales hit an upper threshold – for example $10m of domestic sales.

3.5 Agricultural levies

In 2014, the company paid around $200,000 in agricultural levies for the sale of wool, livestock and grapes. Broadly, the company supports the levy system (as well as the existing federal government co-funding) as an investment into research and marketing programmes which have an ultimate positive profitability benefit to the industry. It is concerning however, that there appears to be no fiscal restraint in these bodies despite the current economic climate – leading to concerns that levy payers are not getting 'bang for buck'. Although the legislation stipulates that levy payers are responsible for setting the levy rate, recent levy ballots have only given options to eliminate the levy, maintain the status quo, or increase levies – no options to decrease levies. A review of this legislation may be in order so that the will of levy payers is heard.

4.0 Rural and remote area bias

It is commonly reported that regional and remote areas are treated unfavourably to their city counterparts due to the lack of infrastructure and services in regional areas. There is also a taxation bias on regional and remote communities because they are more reliant on transportation than urban areas, and therefore any taxation or fee levied in the transport industry is felt more significantly in the bush. Of particular note are on road fuel excise and the excessive registration charges for heavy vehicles.

In order to counter this remote area bias the company suggests extending the zone offset programme (both in area and in magnitude) and increasing the FBT exemptions for remote/regional employees as identified below.

4.1 Remote area housing

Remote area housing is currently exempt from fringe benefits tax, and remote area residential fuel (i.e. gas and electricity) are given a 50% reduction in fringe benefits value. Whilst this tax relief is welcomed by the company, we would like the task force to consider that remote area housing should be classified as a business expense in its entirety. In the agricultural industry, almost all employees live on property. This is because of the distance to services and due to the vagaries of livestock requiring attention outside of standard business hours – some of the company's properties are hundreds of kilometres from grid electricity, mains water, gas, and sewerage, and even sealed roads, let alone supermarkets and government services. For this reason, there is simply no alternative to providing accommodation on site. Therefore, we would argue that remote area housing be fully identified as a business expense and suggest that the task force consider:

- The full FBT exemption be extended to remote area fuel;
- GST input credits be claimed for expenditure on remote area housing; and
- That a partial or full tax deduction, or FBT exemption, be provided for travel from remote areas to localities with government services whether or not they are for business or private purposes.

4.2 Fuel taxes and credits

The company understands the rationale and purpose of on-road fuel excise charges, although noting that whilst these taxes are theoretically predicated towards road spending, rural road users pay more excise (due to longer travel distances) for relatively poorer rural roads. The company strongly objects to various political and media outlets demonising the fuel tax credits scheme as a “subsidy”. Fuel excise is clearly stated as an on-road charge and therefore the tax credit is merely recovering the tax already paid on off road activities performed by mining and agriculture. No one seriously refers to GST input tax credits as a subsidy and as such the company requests that the government refute any similar suggestions when raised.

5.0 State taxes

This section summarises taxation issues raised in McBride’s submission to the South Australian taxation review.

5.1 Payroll Tax

Whilst payroll tax is the highest taxation measure for the state government, the company is of the opinion that it is a tax on wages and therefore a tax on jobs. It has been suggested that payroll tax leads to lower wages and higher prices and so ultimately the businesses are unaffected. Despite the futility of that argument (which government wants lower wages and higher prices), this is rejected by the company because (a) primary production/resources are generally price takers, so this cannot be passed on to consumers; and (b) above award wages are required in order to entice potential employees into rural/remote areas in the first place. It would be far more efficient for the GST to be broadened or increased to replace payroll tax because this would lead to more employment and/or better wages, which employees would be able to spend according to their individual preferences.

5.2 Property Taxes

The company is seeing a disturbing trend of increases to property taxes by stealth with the removal of concessions from the emergency services levy regime in South Australia. In the 2014-15 year, the company’s agricultural component of its emergency services levy increased by 897%.

Land taxes are the third biggest revenue source for the South Australian government. Primary production land, and the primary place of residence are exempted from the tax. If land tax were applied to agricultural property it would be uneconomical to continue operations: a hypothetical land tax calculation (based on current land tax rates) would result in $2.2m additional land tax liability for the company. It is critical that primary production enterprises be exempted or be provided with significant concessions from land taxes due the large tracts of land required (with no alternative uses) for agricultural pursuits.

The company acknowledges the South Australian government’s budget announcement to phase out conveyancing duty from non-farming, non-residential property.

5.3 Insurance taxation

Insurance stamp duty is the most regrettable tax levied in the state. From the point of view of the state, private expenditure on insurance is desirable because it is ultimately the public that pay for insurance shortfalls in times of disaster (for example major bushfires). Therefore, it is inconceivable that the government would want to discourage expenditure on insurance by doubly taxing it (in addition to GST).

5.4 Motor vehicle registration

The company enjoys relief from motor vehicle registration fees by way of primary producers' concessions and this is appreciated by the company. The company argues that heavy vehicle taxation needs to be reviewed. Heavy vehicle registration fees are a burden on the freight industry as they are a significant barrier to entry into the industry, which in turn reduces competition; but also the high costs mean that rigs are required to be utilised to the extreme in order to spread the overhead. This indirectly leads to increased driver fatigue as owner-drivers in particular need to derive maximum usage from the vehicle in order to be profitable.

The replacement of a flat registration charge with a road usage charge (on a per kilometre basis) places an additional burden on rural and remote areas as they necessarily need to drive increased distances in the ordinary course of life, but also because fuel costs are higher in these areas already. The company does not support a road user charge, but if it were to be introduced, it would need to replace registration fees; have a different calculation method for regional areas, and have a mechanism to exclude off road usage of vehicles. In practice, there does not appear to be any equitable method for introducing such a tax.

6.0 Goods and services tax

The company advocates for an increase in either the rate or scope of the goods and services tax, with appropriate safeguards for low/fixed income earners, as a method of eliminating inefficient state taxes. The reasons that this should be seriously considered are: the broad base; the unavoidability of the tax; and the comparative low rate of the tax by world standards. The company does not advocate the increase in the tax to achieve higher revenues, rather as a simplification measure. It is suggested that increases be measured to ensure that the economy is not adversely affected – for example of 1% per year. Whilst the company acknowledges that this will be a difficult proposition politically, a proposal to increase the GST needs to be owned by the federal government – the commonwealth cannot legislate to restrict its own power - so the rhetoric about requiring all state's support should be quashed.

7.0 Tax simplification measures

The company supports the implementation of measures that make tax law simpler to adhere to. It is with regret that the Tax Law Improvement Project (TLIP) of the 1990s was discontinued. Due to this, income tax law is spread across two main pieces of legislation with complexities about which piece of legislation to refer to. It is encouraged that either TLIP be re-convened so the job can be completed, or that the two pieces of legislation be amalgamated.