Re:think – Better Tax, Better Australia

Submission from Food South Australia Inc.

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EXECUTIVE SUMMARY

This submission from Food South Australia deals specifically with corporate incentives to encourage investment in new equipment and technologies, with an aim to increase the competitiveness of small and medium size food and beverage manufacturers.

It should be noted that Food South Australia is also providing input to the Tax Review in South Australia, addressing State tax issues such as payroll taxes, stamp duty, the CPI/SA Government Inflator and competitive neutrality. However, it is our view that addressing state tax reform from both Federal and State Government perspectives, particularly in regards to payroll tax and stamp duty, is necessary.

Our recommendations are to:

1. Provide targeted accounting assistance for food SME’s that helps them to record and access the R&D tax incentive, beyond the sectorial guides produced by the Department of Industry and Science. This assistance could be in the form of subsidised accounting advisory services, freely available online tools and templates to estimate the amount of R&D tax incentives claimable by companies and training to agri-food associations that helps these organisations to assist their members.
2. Simplify the taxation system for SMEs, particularly focusing on industries that have a heavy burden of non-tax regulations, including the food and beverage manufacturing sector.
3. Implement a Business Investment Allowance consistent on an additional 50% tax deduction for capital purchases with a turnover of less than $5 million and less than 20 employees, as per original proposal from the Council of Small Business of Australia.
4. Implement an additional Productivity Investment Allowance, where companies with <u>profits</u> of less than $5 million are allowed to write off 100% of the purchase value of qualifying equipment against their profit in the year of purchase. Qualifying equipment relates to equipment/vehicle/plant changes with a demonstrable benefit in increasing productivity, in the form of reduced use of utilities, transportation, labour efficiency and other aspects enhancing the multifactor productivity of the manufacturing sector.
5. For the Commonwealth to engage with the South Australian Government to address inequalities in payroll taxes, stamp duty, the CPI/SA Government Inflator and competitive neutrality with respect to other States.

Background

Food South Australia Incorporated welcomes the opportunity to make this submission to the Tax White Paper Task Force, in relation to the Tax Reform 2015.

This submission deals specifically with corporate incentives to encourage investment in new equipment and technologies, with an aim to increase the competitiveness of small and medium size (SMEs) food and beverage (F&B) manufacturers. However, this submission also raises perceived inequalities in payroll taxes, stamp duty, the CPI/SA Government Inflator and competitive neutrality with respect to other States. It is the view of food businesses represented by Food South Australia that these inequalities are disadvantaging the industry in this State.

About Food South Australia

Food South Australia Incorporated is the State's peak industry body, with 285 members that represent F&B companies. We also represents businesses that supply or provide services to the F&B industry.

The South Australian Food Industry

In 2013-14, South Australian F&B manufacturers injected an estimated revenue of $8.3 billion to the Australian economy[1]. This revenue combines incomes of about 896 businesses employing 21,102 people. The importance of this sector has been recognised by the Australian Government in its Review of South Australian and Victorian Economies[2], which states that food, wine and agriculture represent a critical growth opportunity in South Australia to accelerate the transition from traditional manufacturing.

Sustainable growth is critical to Australian F&B manufacturers and the Commonwealth's economy. Despite the fact that the food and beverage sector is now the State's largest manufacturing sector in terms of revenue[3], the industry is affected by the same forces that marked the demise of the car industry in Australia – namely the sliding productivity in Australian manufacturing, fiercer competition in global markets and the ever increasing costs of compliance are impacting the industry's ability to grow. The Productivity Commission already identified a negative annual growth rate (– 4.2%) in the multifactor productivity[4] of Australian food manufacturing between 2003 and 2008, as a result of an increase in combined inputs (hours worked and capital services) and a decrease in value addition. The latter was mostly due to a decline in exports and a loss of domestic market share for some products. During 2008-11, the negative annual grow rate stood at – 1.1%[5].

[1] Excluding wine production.

[2] Australian Government. Growing opportunities: South Australian and Victorian comparative advantages. Report of the Panels for the Reviews of the South Australian and Victorian Economies. April 2014

[3] Austin, N. 22/04/15. Food industry in South Australia on cusp of boom. The Advertiser.

[4] Multifactor productivity is a measure of the quantity of output per unit of combined inputs of capital, labour, energy, raw materials and administration/services costs. It is a wider definition that labour productivity, which only focuses in outputs produced per unit of labour.

[5] Barnes, P., Soames, L., Li, C. and Munoz, M. 2013, Productivity in Manufacturing: Measurement and Interpretation, Productivity Commission Staff Working Paper, Canberra.

The F&B industry operates with very tight margins, with an average[6] EBIT[7] of 6% as a percentage of revenue[8]. This profit is heavily affected by the combined effect of transportation, utilities, labour, rent regulatory burdens and the strong Australian dollar[9]. Recent forecasts carried out by Food South Australia[10] indicate that, in order to continue operating by 2020, South Australian food businesses with profit margins below 6% (e.g. smallgoods and cheese manufacturing) must radically cut costs and increase their margins in the next five years. In the case of smallgoods, profits must jump from the current level of 1.6% to at least 5% and in the case of cheese, from the current 2.5% profit margin to at least 5%.

However, increasing profit margins in the current environment on which the food industry operates is not easily achieved. While in other sectors manufacturers may be able to pass any cost increases to consumers, this is not the case in the Australian food sector. Often, contracts with food retailers do not allow for price increases for periods of time that can vary from 1 to 5 years, depending on negotiations. If manufacturers do increase their prices, their products are at risk of losing shelf-space and being substituted by interstate products or imported product. This competition means that local manufacturers must absorb any sudden increases in costs by eating on their already tight margins. The highly competitive food retail environment also means that some of the common assumptions made by Government are incorrect, e.g. that '*in the long run the cost of the tax is likely to be passed onto employees (through lower wages)* ***and consumers (through higher prices)'***[11]. Passing cost increases to consumers is often not an option for Australian food manufacturers.

For F&B manufacturers, investment decisions to increase productivity and competitiveness such as upgrading plant and equipment, training and staff development and commercialising novel products, often take a back seat to other monetary realities, such as keeping a reasonable cash flow while complying with Federal and State taxes. Paradoxically, increasing competitiveness is exactly what the Federal and State governments want to improve the conditions of Australian manufacturers. There is a role for Government in creating positive business conditions to improve the standing of the F&B industry, both domestically and against international competitors.

R&D Tax Incentive

The only current incentive within the tax system that has assisted some F&B companies in keeping pace with new products, processes and technologies is the R&D Tax Incentive. The total amount spent in the Australian food and beverage sector on these activities in 2011-12 was $541.8 million. Compared to the industry revenue in that year (about $90 billion), the expenditure in R&D was only 0.6%, an insignificant amount which indicates that the R&D tax incentive has had little impact in the F&B sector. Zooming into small and medium size businesses, 83% of the R&D expenditure in 2011-12

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[6] Weighted average, taking into account the variation between F&B industry segments and their representation in SA.
[7] Earnings before tax, which is equivalent to profit.
[8] IBISWorld data for 2014.
[9] KPMG, 2014. Competitiveness & Sustainable Growth: challenges for the Australian Food & Grocery Industry. Report for the AFGC.
[10] Food South Australia's report to the Department of Premier and Cabinet 90-Day Project: Addressing trade waste concerns in the food and beverage industry. May 2015.
[11] Re:think - Tax Discussion Paper. Page 143.

was undertaken by large corporations (i.e. with more than 200 employees)[12]. Less than 3% of the F&B annual R&D expenditure is spent by SMEs with less than 20 staff.

Food SMEs are highly innovative, entrepreneurial organisations. However, some Food SA members have explained that the accountancy burden to claim the R&D tax incentive often surpass the benefits. Further, the activities and programs that support innovation do not always tackle industry priorities, such as upgrading plant equipment or implementing best practices through newer technology. A positive return on investment on new equipment is often elusive, particularly in purchases that help management of waste, electricity and other utilities. The effect of ever increasing utility costs are pervasive and have contributed significantly to the erosion of profits in the F&B sector[13].

Recommendation 1

Provide targeted accounting assistance for food SME's that helps them to record and access the R&D tax incentive, beyond the sectorial guides produced by the Department of Industry and Science. This assistance could be in the form of subsidised accounting advisory services, freely available online tools and templates to estimate the amount of R&D tax incentives claimable by companies and training to agri-food associations that helps these organisations to assist their members.

Tax compliance

Food regulations cover extremely important areas such as public health and safety, protection of our international image, enabling consumers to make smart choices in food and preventing misleading and deceptive conduct. However, food manufacturers in Australia have to deal with multiple organisations, both public and private, that apply in each of the areas mentioned. In a Food SA survey[14], 37 respondents identified 21 different organisations that audit their processes every year. A similar accreditation survey in the Riverland food industries[15] revealed 24 accreditation bodies.

Additionally to these regulations, tax compliance has been recognised by the Government as "*the most significant compliance cost faced by small businesses, accounting for between one-half and two-thirds of the total compliance burden on small business*"[16].

Tax compliance costs are indirectly imposed on SMEs to make sure that the correct tax treatments are applied and avoid issues in the future. This is a disincentive for SMEs, as these compliance costs only get more efficient as businesses grow and create an internal critical mass. This disincentive also takes readily available funds away from innovation, investment, staff numbers etc.

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[12] Australian Bureau of Statistics. 8104.0 - Research and Experimental Development, Businesses, Australia, 2011-12.

[13] KPMG. 2014. Competitive and Sustainable Growth: Challenges for the Australian Food and Grocery Industry. AFGC.P. 32

[14] Sargent, T; Makrid, M; Estrada-Flores, S; and Barnett, C. State of the SA Food Industry 2013. February 2014. Food South Australia Report.22 pp.

[15] Estrada-Flores, S. and McNaughton, K. Consolidation of Accreditation Audits for the Riverland Food industry. Food SA and SARDI. Sept 2013.

[16] Tax discussion paper, page 112. March 2015

Recommendation 2

Simplify the taxation system for SMEs, particularly focusing on industries that have a heavy burden of other non-tax regulations, including the food and beverage manufacturing sector.

Accelerated Depreciation/Investment Allowance for SMEs: The idea of accelerated depreciation is not new in Australia: some of the recommendations from the Henry Tax Review included a reduction in the company income tax rate and new small business asset write-off and depreciation rules. Several countries including The Netherlands[17], China[18], Singapore[19] and Ireland[20] have accelerated depreciation provisions for a range of equipment. The benefits of such incentives to increase technology uptake and support competitiveness has been demonstrated in these countries.

Recently, the Council of Small Business of Australia (COSBOA) proposed a new Business Investment Allowance for businesses, in the form of an additional tax deduction available for the purchase of plant, equipment and vehicles and encourages business people to invest in income-producing business assets.

COSBOA[21] advocates for this measure for businesses with a turnover of less than $5 million and less than 20 employees, following the conditions below:

- Additional 50% tax deduction available for capital purchases.
- Eligible assets must be tangible and depreciable.
- Eligible assets must cost between $1,000 and $2,000,000 (excluding GST).
- Covers new and used plant, equipment and vehicles, on the premise that an allowance that applies only to new assets could result in offshore purchases and could disadvantage local second-hand machinery sales.

The recently announced Federal Budget 2015 did not fully deliver on this proposal. The new measures assisting businesses were:

1. Small businesses (i.e. with less than $2 million annual revenue) can claim immediate tax deductions on machinery or equipment for use in their business, provided the cost of the asset is less than $20,000. The tax break is available for all eligible purchase until June 30, 2017.
2. Companies with annual turnover of less than $2 million will have their tax rate lowered, from 30% to 28.5%.

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[17] http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Netherlands-Corporate-Deductions
[18] http://www.cmslegal.com/China-encourages-accelerated-depreciation--Deduction-of-fixed-asset-costs-before-corporate-income-tax--Tax-Connect-Flash-17-12-2014
[19] http://www.nea.gov.sg/grants-awards/energy-efficiency/one-year-accelerated-depreciation-allowance-for-energy-efficient-equipment-and-technology-%28adas%29
[20] http://www.seai.ie/Your_Business/Accelerated_Capital_Allowance/
[21] Strong, P., and Gandolfo, D. 30/04/2015. Why small business needs an investment allowance. Smart Company.

The Australian Bureau of Statistics[22] estimates the following distribution of food processing businesses in South Australia.

Table 1. Number of food processing businesses in South Australia.

Revenue bracket	Number of businesses	% Businesses
$2m or more	133	14%
$200k to less than $2m	452	48%
$50k to less than $200k	219	23%
Zero to less than $50k	135	15%
TOTAL	939	100%

The Budget measures described before do not assist medium and large businesses that are expanding or have plans to grow, over the $2 million threshold. In South Australia, this unassisted segment represents 133 food and beverage businesses. In terms of representation, we estimate that the budget measures leave out approximately 70% of the Food South Australia membership, which also represent the most progressive companies in the food and beverage industry.

Recommendation 3

Implement a Business Investment Allowance consistent on an additional 50% tax deduction for capital purchases of with a turnover of less than $5 million and less than 20 employees, as per original proposal from the Council of Small Business of Australia.

Accelerated Depreciation/Productivity Investment Allowance:

As discussed above, the recently announced Budget 2015 measures for businesses do not benefit a total of 133 F&B businesses in SA, which represent some of the most forward thinking, progressive companies in the State. It is unfortunate that these businesses, which lead the charge in becoming more efficient, more productive and more sustainable, are not supported further in their projects.

Qualifying equipment can include equipment/vehicle/plant changes with a demonstrable benefit in:

- Energy and water efficiency.
- Wastewater and solid waste efficiency.
- Formulation and process optimisation.
- Reduction of transport/logistics costs.
- Materials handling efficiency.
- Decrease of downtime.
- Space footprint.

[22] 81650 Counts of Australian Businesses, including Entries and Exits, Jun 2009 to Jun 2013.

This proposal is complementary to the budget measures, where businesses that do not qualify on the basis of turnover can still apply on the basis of demonstrable improvements on competitiveness and productivity.

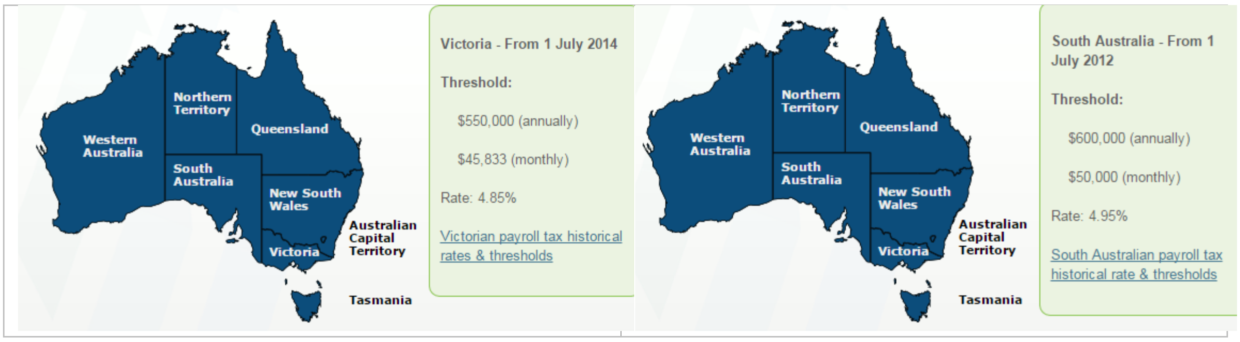
Recommendation 4

Implement an additional Productivity Investment Allowance, where companies with profits of less than $5 million are allowed to write off 100% of the purchase value of qualifying equipment against their profit in the year of purchase. Qualifying equipment relates to equipment/vehicle/plant changes with a demonstrable benefit in increasing productivity, in the form of reduced use of utilities, transportation, labour efficiency and other aspects enhancing the multifactor productivity of the manufacturing sector.

State-based Taxes

Payroll taxes: There is a generalised view among the industry that payroll taxes are excessive for the food & beverage industry, where a high employer such as F&B is penalised due its labour-intensive nature. Payroll tax becomes a burden for companies that have a highly positive impact on employment, particularly in regional Australia. We acknowledge that this is a state issue, but has an impact on the Australian economy.

Further, payroll taxes differ from State to State. The following figure, which shows the annual and monthly threshold for wages applied per State and the corresponding percentage tax rates, illustrates this fact[23]. The figures have been ordered from the lowest threshold to the highest threshold[24]. South Australia is only second to Victoria in regards to the threshold.



[23] http://www.payrolltax.gov.au/harmonisation/payroll-tax-rates-and-thresholds

[24] The lower the threshold, the more businesses are paying this tax and the more affected SMEs are by payroll taxes.

It has been argued that, unlike a reduction in the company tax rate, abolishing payroll tax would benefit employers based on turnover rather than whether their business is incorporated or not[25]. However, the Federal Government's recent tax discussion paper indicates that the Government "relies more on payroll tax than other OECD countries". In Victoria, payroll tax is nearly a third of the Victorian government's $19 billion projected tax revenue.

Therefore, if abolishing the payroll tax is not an option, ensuring that this tax does not disadvantage manufacturers in SA with respect to other States is the second best option.

Some organisations in South Australia have called for a rise in the threshold tax to $750,000. A common theme in an industry survey carried out by Food SA is that food industry employers cannot find employees that would accept salaries below $45,000, particularly in metropolitan Adelaide[26]. Indeed, official statistics indicate that the average annual salary paid in the F&B industry to employees in 2012-13 was $50,300[27]. Therefore, a threshold of $750,000 at an average salary of $50,000 per year per employee would mean that companies with 15 full time employees or over would be over the proposed threshold.

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[25] DIISRTE. Food Processing Industry Strategy Group. Report of Non-Government Members. September 2012.
[26] Food South Australia. State of the SA Food Industry 2013.Issues faced by food manufacturers in South Australia. March 2014.
[27] ABS. 81550DO003_201213 Australian Industry, 2012-13

Recommendation 5

For the South Australian Government to increase the South Australian payroll tax threshold from the current levels of $600,000 to $1,000,000 and ensure a level playing field for food companies settled (or planning to settle) in South Australia.
For the Federal Government to engage with the South Australian Government to address inequalities in payroll taxes, stamp duty, the CPI/SA Government Inflator and competitive neutrality with respect to other States.