

23 May 2014

Review into tax system impediments facing small business
The Board of Taxation
C/- The Treasury
Langton Crescent
CANBERRA ACT 2600

Dear Sir/Madam

We write to you in relation to both the review into tax impediments facing small business and the concurrent review into Division 7A, Part III of *The Income Tax Assessment Act 1936*. We note the extension granted to allow us to include Division 7A comment at the same time as our response to the tax impediments facing small business review.

Executive Summary

Business SA has joined with other Chambers of Commerce and Industry through the Australian Chamber of Commerce and Industry (ACCI) to make a joint submission to the review into tax impediments facing small business. We refer the Board of Taxation to ACCI's submission which reflects the views of Business SA.

While ACCI's submission canvasses a range of taxation issues impacting small businesses, we emphasise that for Business SA members payroll tax remains the tax that most limits small businesses' ability to expand. In a survey of members conducted in May 2014 for this review, over half of respondents cited payroll tax as the tax or levy most limiting the expansion of their business. In terms of compliance issues, the frequency of BAS statements remains the most significant issue for small businesses.

Furthermore, members cited in our survey that the complexity of the R&D tax incentive is prohibiting its adoption, with comments such as:

"Too much red tape and not enough incentive"

"Very difficult for business owners and non specialist advisers to grasp and to determine actual benefits upfront"

"Too much work in getting and supporting the tax incentive to make it of value"

Specific comment on Division 7A, Part III of *The Income Tax Assessment Act 1936*

1. There is no real dispute from businesses that measures need to be in place to ensure company profits which are distributed to shareholders for private use are deemed dividends. However, any changes to Division 7A need to make it easier for company shareholders to draw down capital for working capital purposes which is the whole intention of Division 7A.
2. In a recent survey of members, the majority were aware of how Division 7A worked and advised its current operation is too restrictive on business activities in terms of using company profits through shareholder loans for legitimate working capital purposes.
3. The main contention around proposed changes to Division 7A relates to the 'Statutory Interest Model' whereby companies would only be able to structure shareholder loans for working capital for 10 year terms with set repayments; 25% by end of year 3, 45% by end of year 5, 75% by end of year 8 and 100% at expiry. Many loans to shareholders for working capital need to be over a much longer period and not be restricted by arbitrary capital repayments. A 25 year loan term maximum would be much more appropriate without caveats around property being used as security. Furthermore, interest on loans to generate taxable income should be deductible.
4. Under the 'Statutory Interest Model', having to pay a commercial rate of interest which is the RBA small overdraft indicator rate is not reflective of the actual rate of interest most small businesses would, or should be, paying with respect to shareholder loans. The RBA indicator rate is also the highest bank overdraft rate given it does not reflect rates for loans above \$20,000.

Furthermore, using the RBA indicator rate does not reflect rates which businesses can borrow through related companies (obviously because the parties are known to each other, they are willing to lend at a lower rate reflecting less perceived risk.) This is summarised concisely by one of our members who said:

"We have loans to our share-holders as part of our Discretionary Trust. We mostly use Commercial rates of interest. However I believe that it should be in the businesses best interest to decide what rate & term of loan is required. This has allowed us to gain equity from our parents rather than having loans with banks. We probably wouldn't be in business if we had to have the same loans with the banks, we like the flexibility of using our parents equity - it works well for our small business. Restricting this would place a lot of un-necessary burden on small business. They need the flexibility."

5. Business SA supports the Government's proposed abolishment of asset re-valuations as part of its proposed changes to Division 7A.

Who we are

As South Australia's peak Chamber of Commerce and Industry, Business SA is South Australia's leading business membership organisation. We represent thousands of businesses through direct membership and affiliated industry associations. These businesses come from all industry sectors, ranging in size from micro-business to multi-national companies. Business SA advocates on behalf of business to propose legislative, regulatory and policy reforms and programs for sustainable economic growth in South Australia.

Should you require any further information or have any questions, please contact Rick Cairney, Director of Policy, Business SA on (08) 8300 0060 or rickc@business-sa.com.

Yours sincerely

Nigel McBride
Chief Executive Officer