Master Builders Australia

“Re: Think: Tax Discussion Paper”

June 2015

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1 Introduction

1.1 Master Builders Australia is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder state and territory Associations.

1.2 Over 125 years the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.

1.3 The building and construction industry is a major driver of the Australian economy and makes a major contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter.

1.4 At the same time, the wellbeing of the building and construction industry is closely linked to the general state of the domestic economy.

2 Overview

2.1 The Australian taxation system must be efficient and globally competitive if the nation is to meet the major economic and public policy challenges ahead, keeping Australia as an attractive destination for investment and to maintain capital inflows.

2.1.1 The tax reform process must make a substantial and positive contribution to lifting Australia's national (and key sectoral) productivity outcomes.

2.2 The building and construction sector is one of the most intensely taxed in Australia, and bears a direct and indirect tax burden from all levels of government — Federal, State and Territory and Local.

2.2.1 This high and onerous tax burden distorts investment decisions, discourages entrepreneurship and innovation, reduces business investment and employment opportunities, and diverts scarce resources into unproductive and unnecessarily costly tax compliance within a key sector of the Australian economy.

2.3 More needs to be done to ensure the tax system also rewards entrepreneurship and reduces compliance costs for business particularly small business. The Federal Government’s current tax review is an opportunity to lay down a pathway to achieve a more efficient and competitive taxation regime in Australia.

2.4 Master Builders calls for a holistic approach to tax reform. Measures must not be considered in isolation or as single issue trade-offs, or in response to short term fiscal pressures. Rather, the final Tax White Paper must be a comprehensive, detailed, and specific ‘blueprint’/package, for the medium to longer term.

2.5 Master Builders’ high level tax reform priorities call for:

- a comprehensive review of the narrow Goods and Services Tax (GST) base;
- any increase in the GST rate must not be undertaken without first effecting comprehensive tax reform;
- reducing the company tax rate to 25 per cent;
- reducing the differential between the higher marginal personal income tax rates and the company tax rate;
- simplifying tax compliance, especially for small business to free up entrepreneurial energies for more productive purposes, such as generating investment, employment and productivity;
- providing incentives for the removal of inefficient state taxes including infrastructure taxes, charges and levies;
- introducing a reducing, stepped rate of capital gains tax; and,
- retaining the tax exempt status of home ownership and negative gearing.

2.6 While Master Builders tax agenda has a number of elements, addressing particular taxation issues, ultimately any meaningful (and sustainable) tax reform must be considered holistically; as a package. This, in turn, requires:

- ensuring any proposed changes are not seen as simple trade-offs; and,
- ensuring the proposed tax reform package is subject to detailed analysis for its efficiency, its global competitiveness, its sustainability, and importantly, encouraging investment and employment within the domestic economy.

3 Master Builders Tax Reform Agenda

3.1 The Australian taxation system must be efficient, globally competitive and fair if the nation is to meet the major economic and public policy challenges ahead, to keep Australia as an attractive destination for investment and to maintain capital inflows.

3.1.1 Key challenges are: structural integrity of the budget, ageing of the population; globalisation of the world economy; continuing structural change; lifting productivity performance; and improving international competitiveness.

3.2 More needs to be done to ensure the tax system rewards entrepreneurship and reduces compliance costs for business particularly small business. In this context, the Federal Government’s current tax review is an opportunity to lay down a pathway to achieve a more efficient taxation regime in Australia.

3.3 The building and construction sector is one of the most intensely taxed in Australia, and bears a direct and indirect tax burden from all levels of government — Federal, State and Territory and Local.

3.3.1 This high and onerous tax burden distorts investment decisions, discourages entrepreneurship and innovation, reduces business investment and employment opportunities, and diverts scarce resources into unproductive and unnecessarily costly tax compliance within a key sector of the Australian economy.

3.3.2 These impacts, in turn, reduce housing affordability, increase housing stress and add to the fiscal burden on governments for housing assistance.

3.4 Master Builders believes a holistic approach to tax reform is essential. Measures must not be considered in isolation or as single issue trade-offs. Rather, the tax “blueprint” must be a comprehensive, detailed, and specific package that allows zero “wriggle room” in terms of execution.

3.5 Master Builders’ high level tax reform priorities call for:

- a comprehensive review of the narrow GST base;
- any increase in the GST rate must not be undertake n without first effecting comprehensive tax reform;
- reducing the company tax rate to 25 per cent;
- reducing the differential between the higher marginal personal income tax rates and the company tax rate;
- simplifying tax compliance, especially for small business to free up entrepreneurial energies for more productive purposes, such as generating investment, employment and productivity;
- retaining the tax exempt status of home ownership and negative gearing;
- providing incentives for the removal of inefficient state taxes including infrastructure taxes, charges and levies; and,
- introducing a reducing, stepped rate of capital gains tax.

3.6 In the context of Master Builders’ call for a reduction in the company tax rate to 25 per cent, to match other countries and to ensure Australia does not slip further behind in terms of international competitiveness.

3.6.1 Master Builders therefore recommends further reductions in the company tax rate which maintains Australia’s global tax competitiveness.

3.6.2 Master Builders welcomes the Federal Government’s commitment to cutting the company tax rate, but believes a transitioning of the rate to 25 per cent by 2025 (if not earlier) should be the aim, subject to successful resolution of the structural deficit.

3.7 Master Builders calls for a reduction in the differential between the higher marginal personal income tax rates and the company tax rate.

3.7.1 Such a measure would help improve tax compliance and lower income tax rates, and thus improve productivity and workforce participation (especially by secondary and marginal earners) and act as an incentive for domestic saving which would, in turn, lower the cost of capital for business, especially smaller firms.

3.8 In the area of capital gains tax (CGT), Master Builders calls for the introduction of a reducing stepped rate of capital gains. This would encourage longer-time horizon investment as well as discourage speculative investments.

3.8.1 Master Builders would propose assets held for: less than 1 year have 100 per cent of CGT subject to tax; 1 to 2 years have 50 per cent of CGT subject to tax; 2 to 5 years have 25 per cent of CGT subject to tax; 5 to 10 years have 10 per cent of CGT subject to tax; and more than 10 years have 0 per cent subject to tax (that is, CGT free).

3.9 In the area of tax simplification, Master Builders continues to call for ongoing efforts to simplify business tax compliance.

3.9.1 The inefficient collection and administration of taxes distorts economic decision making. Raising revenue to fund government outlays must be done as efficiently as possible. And the increasing complexity and volume of Australia's tax law represents an ongoing burden for Australian business.

3.10 Resources devoted to compliance with an unnecessarily complex tax system could be used more productively.

3.10.1 Master Builders is also particularly concerned that complexity and its resulting compliance burden falls disproportionately on small business which cannot take advantage of economies of scale. This unfairly disadvantages small businesses relative to large.

3.11 Removal of inefficient state taxes should be a priority.

3.11.1 Stamp duties discourage residential and commercial property transactions. The duties manifest themselves widely at the State level and can represent a significant burden to home buyers.

3.12 Master Builders calls for, as a first step, the careful consideration of the potential benefits of the abolition of stamp duty on residential property. The reason for caution is twofold.

3.12.1 First, such a step must not be considered in isolation – revenue from stamp duties is significant and any proposed offsetting revenue needs to be carefully considered in terms of its impact. 'Fixing' one problem must not lead to the creation of another problem.

3.12.2 Secondly, given the history of tax reform the process, governance and legislation are all critical ingredients that need to be "locked-in" so as to engender confidence that undertakings will be honoured.

3.12.3 In this context, Master Builders notes with considerable concern the commitment to abolish stamp duties on business conveyances made in the 1999 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations that, a decade and a half later, has not been fully delivered.

3.12.4 In calling for the abolition of stamp duty, Master Builders emphasises this initiative must be part of a holistic approach which must include, as a higher priority, a review of the GST. Simply substituting land taxes for stamp duties does not, of itself, constitute comprehensive tax reform; reform of the GST is.

3.13 As noted earlier, the key to good tax reform must be to take a holistic approach, not viewing measures in isolation or as single issue trade-offs. To repeat, the tax "blueprint" must be a comprehensive, detailed, and specific package that allows zero "wriggle room" in terms of execution.

3.14 For the same reasons, Master Builders would not support an increase in the Goods and Services Tax rate without first effecting significant and 'enabled' tax reform of its narrow base.

3.14.1 Master Builders recommends that the cumulative influence of GST be removed. In particular, GST imposed on stamp duty is unacceptable. It is a tax on a tax.

3.14.2 For example, on a warranty insurance premium for domestic builders, GST is first applied to the premium, followed by an additional 10 per cent stamp duty. A broker’s fee is calculated, which in turn has GST added to it. Master Builders’ view is that the stamp duty should be calculated on the GST excluded premium price.

4 Housing Tax Burden

4.1 The building and construction sector is one of the most intensely taxed in Australia, and bears a direct and indirect tax burden from all levels of government — Federal, State and Territory, and Local.

4.1.1 This high and onerous tax burden distorts investment decisions, discourages entrepreneurship and innovation, reduces business investment and employment opportunities, and diverts scarce resources into unproductive and unnecessarily costly tax compliance within a key sector of the Australian economy.

4.1.2 These impacts, in turn, reduce housing affordability, increase housing stress and add to the fiscal burden on governments for housing assistance.

4.2 The Tax Discussion Paper (TDP), and the Green and White Papers which are expected to follow, constitute an important, and not-to-be-missed, opportunity for reducing the tax burden on industry, and small businesses in particular.

4.3 The TDP (Australian Government, 2015) highlights the importance of residential housing, especially owner-occupied housing, within the Australian economy, observing (at pages 66 to 67):

- Housing is both a consumer durable (a place to live) and an investment (representing a sizeable proportion of household wealth); and,

- Australian households hold some 43 per cent of their wealth in the family home, with 67 per cent of the population living in their own home.

4.4 In this context, the Tax Discussion Paper (at page 67) states:

> *“Given the central importance of the home for Australian families, there is a strong consensus that it would not be appropriate to tax either the imputed rent on owner-occupied housing or capital gains derived from it.”*

4.5 While the family home may attract more favourable tax treatment relative to other asset classes, it would be wrong to regard the family home as tax-free. Rather, it is subject to some of the most inefficient and insidious taxes operating within the Australian taxation system in its construction, purchase and occupancy.

4.6 The CIE published an important report examining the incidence and distribution of the tax burden on residential housing (CIE, 2011). The study underscored the relatively onerous tax burden carried by the building and construction industry, when it noted (CIE, 2011: 7 - 8), inter alia:

- new residential housing accounts for 1.2 per cent of value added within the Australian economy, but contribute 2.8 per cent of total government revenues. For established housing, the figures are 7 per cent and 8.8 per cent respectively;
- the average tax burden on the new housing sector is around 31 per cent of the value of output, compared to just over 24 per cent for the economy as a whole; and,
- residential property taxes and charges account for more than 40 per cent of the taxation revenue of State and Local Governments, or around 12 per cent of all government revenue, in Australia.

4.7 The CIE report was also critical of the burden of the inefficient taxes imposed on the residential building sector, and as a result home buyers.

4.7.1 Inefficient taxes were seen to include the effects of zoning on land prices, excessive regulatory requirements in building code(s), the adverse impact of planning delays and uncertainties in planning in the risk premia required by builders, and excessive infrastructure charges.

4.7.2 Such inefficient taxes could add as much as $141,000 to the price of a new house in a greenfields area of Sydney, more than $79,000 to a similar dwelling in Melbourne, and nearly $79,000 in Brisbane (in 2011 dollar terms).

4.8 The CIE report also contained informative modelling of the effects of housing taxation on the broader construction sector, and on the dwelling construction sector in particular.

4.9 Amongst the main findings were:

- home buyers are more tax-sensitive than home builders to movements in housing taxes, which reflects the tendency for housing taxes to fall more heavily on home buyers/owners/renters; and,

- a given reduction in stamp duties and other capital taxes on housing (for example, to the value of $500 M) would likely see the supply costs of dwellings fall by just over 0.3 per cent, and/or the quantity of dwellings supplied rise by a similar amount (0.3 per cent).

4.10 A study by BIS Shrapnel (BS, 2011) examined the cost components of new house prices across Australia's major capital cities covering the period from 1994 to 2010.

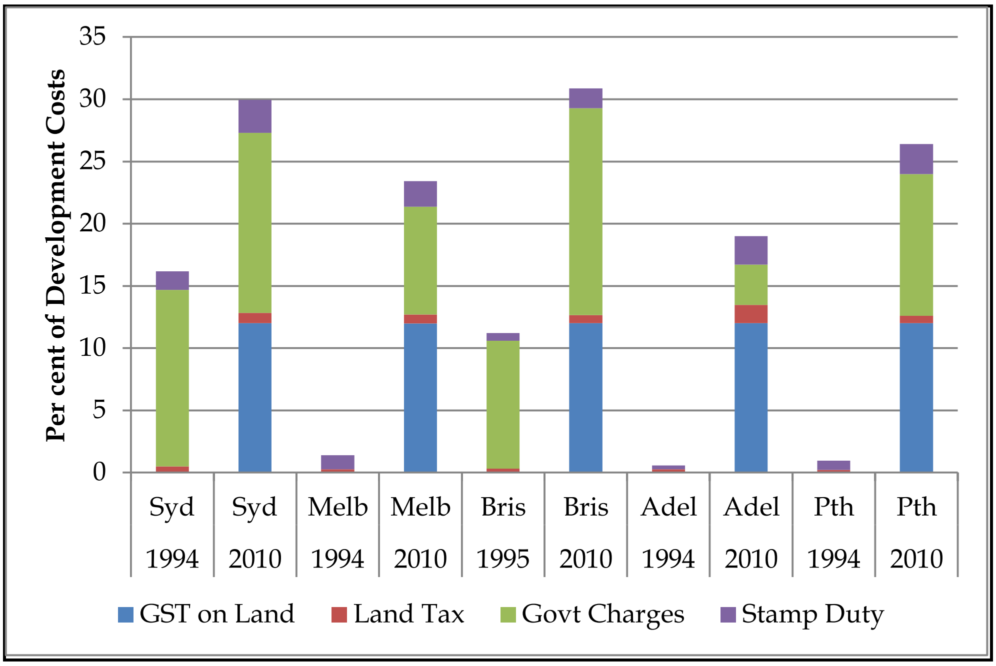
4.11 The study focused in particular on the costs of acquiring and developing land for residential development, examining both taxation and non-taxation costs.

4.11.1 Key non-taxation costs included the price of land, development costs (for example, consultant fees, interest payable), and marketing and sale charges.

4.11.2 The taxation costs included land tax, developer/infrastructure and related charges, stamp duties, and the GST payable on land.

4.12 Graph 3.1 following reports the tax burden on residential land development, measured as a share of total development costs, for the five mainland capital cities for both 1994 and 2010 (except for Brisbane, which is 1995 and 2010), including the GST on land.

Graph 3.1: Tax Burden on Residential Land Development

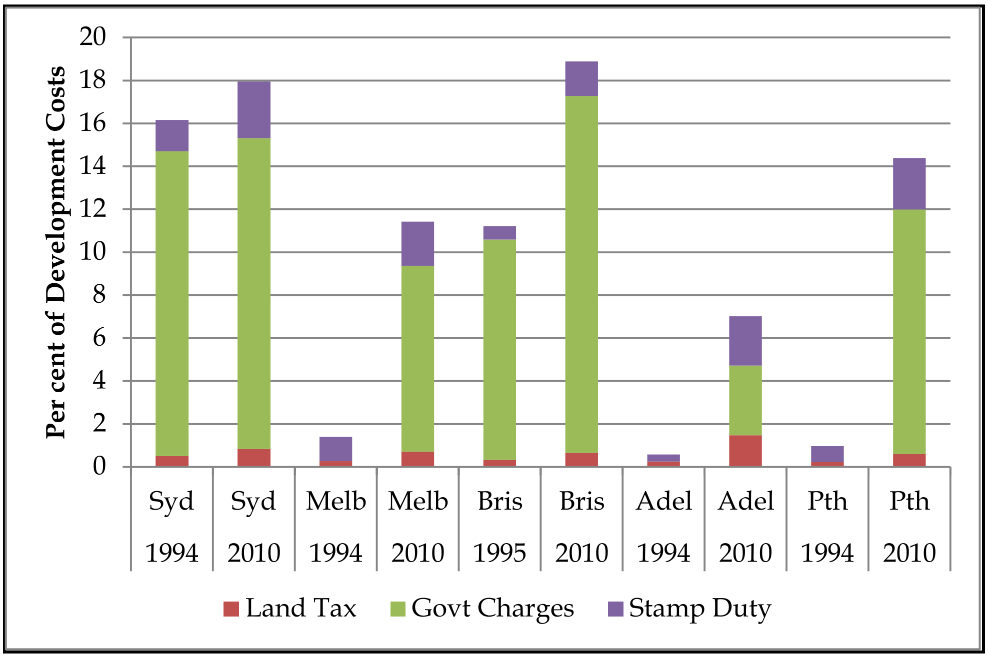


4.13 The tax burden imposed on the development of land for residential use shot up in all of the mainland capital cities between the mid-1990s and 2010, and was not just the result of the introduction of the GST in 2001. For example, in:

- Sydney, the tax burden rose from 16.2 per cent of total development costs in 1994 to 30 per cent in 2010;
- Melbourne, it rocketed from just 1.4 per cent in 1994 to 23.4 per cent in 2010, with government charges and levies accounting for 8.6 per centage points of this increase;
- Brisbane, it almost trebled, from 11.2 per cent in 1995 to 30.9 per cent in 2010, with increasing government charges and levies accounting for 6.3 per centage points of this increase;
- Adelaide, it catapulted from a mere 0.6 per cent in 1994 to 19 per cent in 2010, with land tax, government charges and stamp duties accounting for 7 per centage points of the overall burden in 2010; and,
- Perth, it soared from just 1 per cent in 1995 to 26.4 per cent in 2010, with government charges and levies going from zero in 1994 to an 11.4 per cent share in 2010.

4.14 Graph 3.2 reports the same data, without the GST on land, to highlight the practical importance of government charges and levies on the costs of developing land for residential use.

Graph 3.2: Non-GST Tax Burden on Residential Land Development



4.15 A stand-out feature of Graph 3.2 is the marked increase in the burden of government charges and levies on land development for residential use in a number of the mainland capital cities. For example, in:

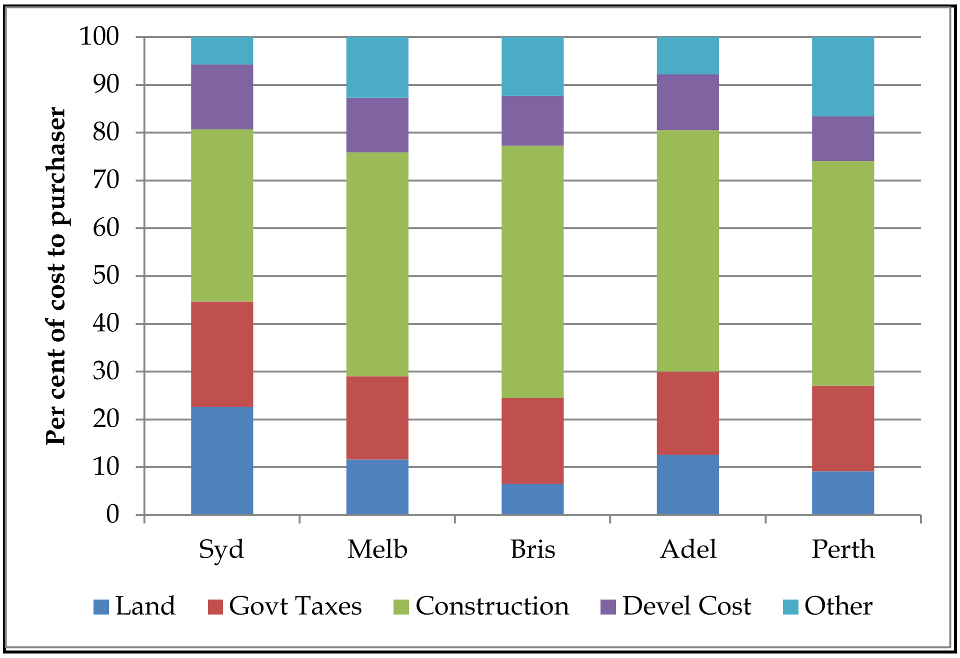
- Melbourne, such expenses accounted for 76 per cent of total non-GST taxes and charges on land development for residential use in 2010 (compared to zero in 1994);
- Adelaide, they accounted for 46.2 per cent of such charges in 2010 (compared to zero in 1994); and,
- Perth, they accounted for 79.2 per cent of such charges in 2010 (again, compared to zero in 1994).

4.16 A study by Urbis (Urbis 2011) went further examining, inter alia, the incidence of government taxes and charges on residential construction in greenfields and infill areas, and on the total costs of construction (that is, taking into account both land and dwelling build costs).

4.16.1 The main government taxes and charges considered were the GST, infrastructure (also known as developer) charges, and stamp duties.

4.17 Graph 3.3 reports the burden of government taxes and charges on greenfields development across the mainland State capital cities in 2010.

Graph 3.3: Government Taxes on Greenfields Development

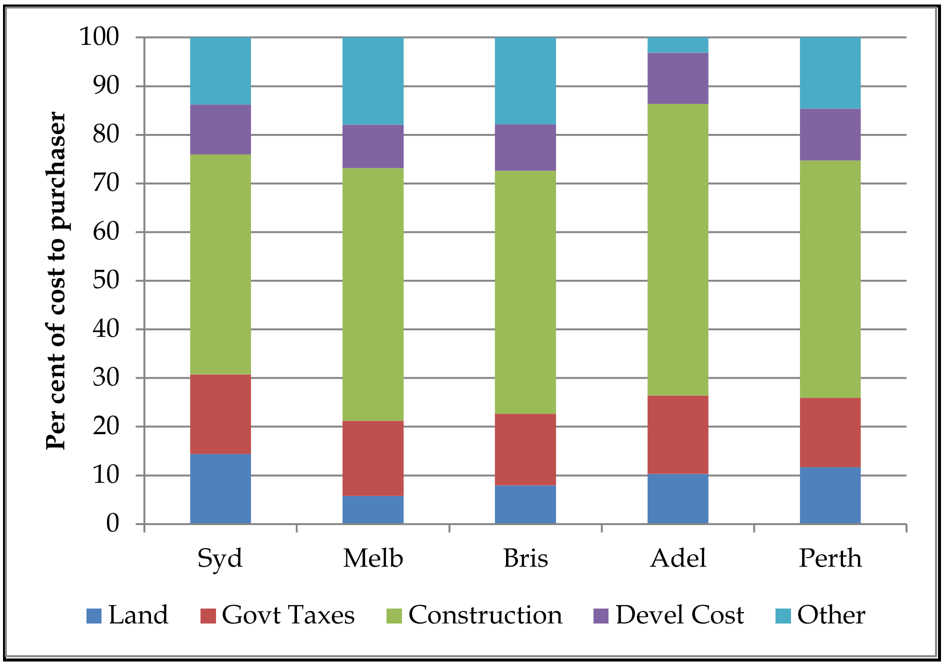


4.18 Government taxes and charges accounted for between 17 to 18 per cent of the total cost to the purchaser of a greenfield dwelling in Melbourne, Brisbane, Adelaide and Perth, and 22 per cent in Sydney.

4.18.1 Looked at another way, government taxes (as a share of the total cost to the greenfields dwelling purchaser) were 2.8 times the cost of land in Brisbane, 2 times the cost of land in Perth, and between 1 and 1.5 times the cost of land in the other mainland State capital cities.

4.19 Graph 3.4 reports the burden of government taxes and charges on infill development across the mainland State capital cities in 2010.

Graph 3.4: Government Taxes on Infill Development



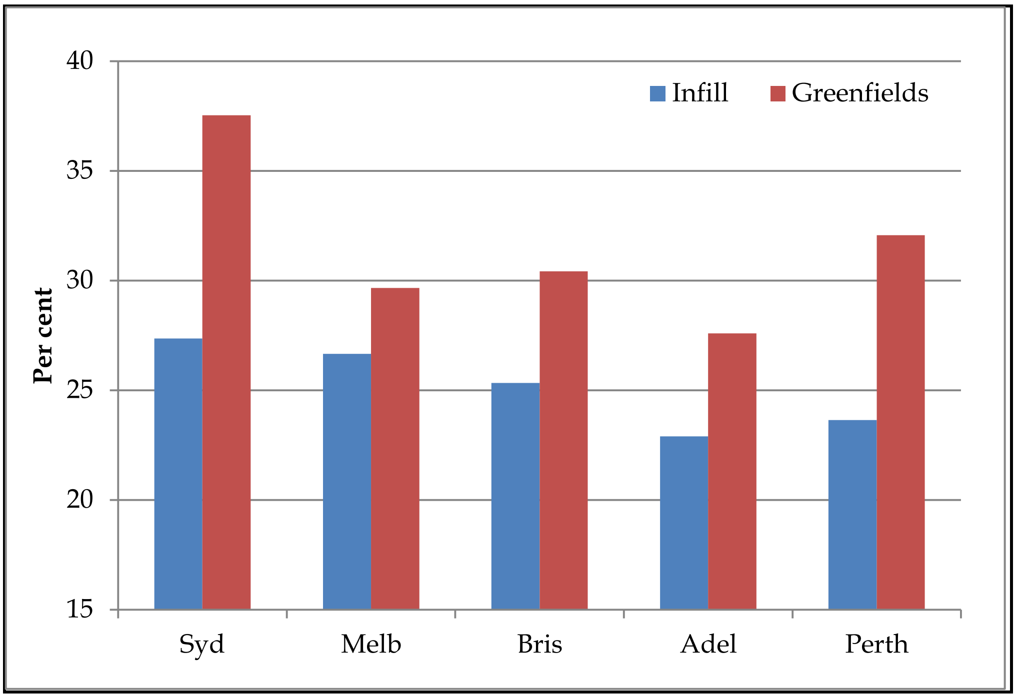
4.20 Government taxes and charges accounted for between 14 to just over 16 per cent of the total cost to the purchaser of an infill dwelling in all of the mainland State capital cities.

4.20.1 Looked at another way, government taxes (as a share of the total cost to the infill dwelling purchaser) were 2.7 times the cost of land in Melbourne, 1.8 times the cost of land in Brisbane, and between 1 and 1.6 times the cost of land in the other mainland State capital cities.

4.20.2 Taken together, these figures point toward government policy favouring infill over greenfields residential development – that is, the tax burden on infill development is generally less than that on greenfields development.

4.21 Graph 3.5 reports the burden of government taxes and charges on greenfields and infill residential development across the mainland State capital cities in 2010, measured as a proportion of land and construction costs (that is, the elements usually most visible to home buyers).

Graph 3.5: Government Taxes on Development



4.22 Government taxes on greenfields residential developments, as a share of land and construction costs, exceed those for infill development across all of the mainland capital cities.

4.22.1 The differentials are greatest in Sydney and Perth (where taxes on greenfields developments are almost 40 per cent higher than those on infill developments), with the margins being around 20 per cent for Brisbane and Adelaide, and 11 per cent for Melbourne.

4.23 This profile underscores the point made earlier: government policy on the taxation of residential development favours infill, and penalises greenfields, developments in all of the mainland capital cities; only the magnitude of the penalty is different.

4.24 KPMG Econtech produced a study (KPMG Econtech, 2010) estimating the efficiency costs of a number of different taxes. While the study had a wider focus, a number of the taxes examined impact the building and construction industry.

4.25 The study estimated two forms of economic inefficiency arising from the application of the taxes under review, namely:

- marginal excess burden (MEB), which reflects the loss in economic efficiency resulting from *a small increase* in the tax concerned from its existing level relative to the expected net gain in government revenue. In short, it is the economic impact in cents per dollar of additional revenue; and,

- average excess burden (AEB), which reflects the loss in economic efficiency resulting from *the introduction* of the tax concerned, again expressed in terms of cents per dollar of additional revenue.

4.26 In plain terms, the MEB measures the economic impact of increasing (or decreasing) the tax concerned, while the AEB measures the impact of abolishing the tax concerned.

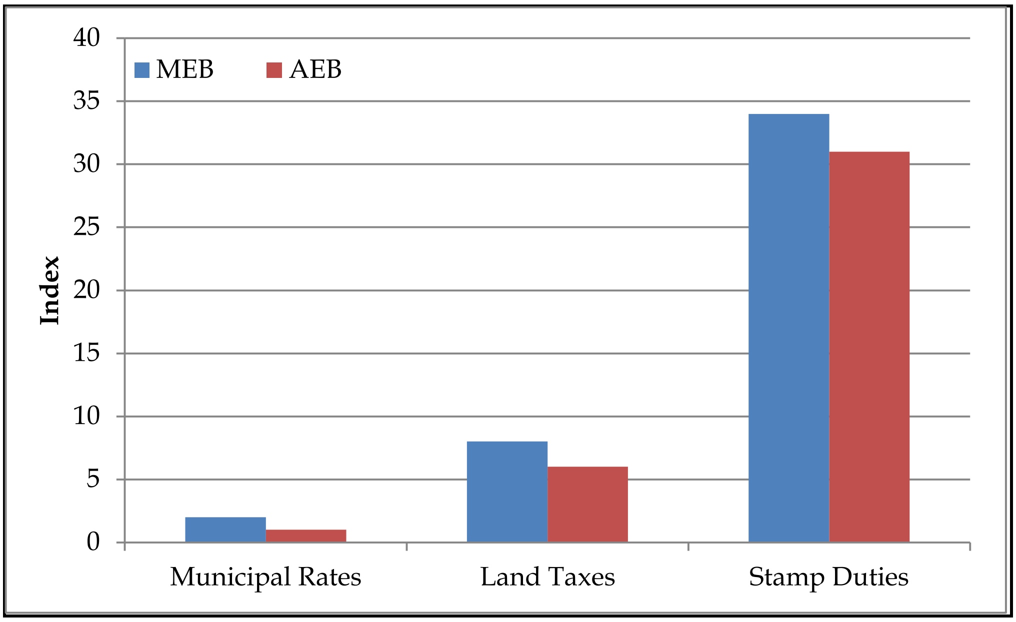
4.26.1 The KPMG Econtech report (at pages 19 – 20) indicates the MEBs are particularly useful for assessing the likely impact of small changes, while the AEBs are better suited to assessing the likely impact of major reforms, to the taxes concerned (and any re-mixing of the overall taxation burden).

4.27 Graph 3.6 summarises the MEBs and the AEBs for three taxes which have particular resonance for the building and construction industry (although the figures reported below are for the whole economy, so are likely to under-estimate their impact on the building and construction industry).

4.27.1 The three taxes of particular interest are municipal rates, land taxes, and stamp duties on the conveyance of real property.

4.27.2 The higher the MEB, the greater the loss of economic efficiency associated with any increase in that tax; the greater the AEB, the greater the loss in economic efficiency associated with the continued existence of that tax (or the greater the gain in economic efficiency likely from the abolition of that tax).

Graph 3.6: The Efficiency Costs of Taxes



4.28 In general, macro-economic terms, municipal rates and land taxes have fairly low impacts on economic efficiency, whether measured on an MEB or an AEB basis. That is, the presence (AEB) and/or raising (MEB) of such taxes has a small effect on general economic efficiency.

4.29 By contrast, stamp duties on conveyances, such as commercial and residential property, have high impacts on economic efficiency, implying any increase in the stamp duty burden would have a sizeable adverse impact on economic efficiency, while abolition of such taxes would likely lead to a strong improvement in economic efficiency.

4.30 Looked at another way, the ratio of the MEB for stamp duties to land taxes is around 4.2 times, while for AEB it is 5.2 times, suggesting any substitution of the former for the latter, ceteris paribus, could deliver a boost to economic efficiency.

4.31 The KPMG Econtech report (at page 77) goes on to point out:

- Their estimates of the MEBs and AEBs on conveyance stamp duties for real property are likely to be conservative, as they do not take into account the distortive effects of such taxes on the purchasing/ selling decisions of households and/or businesses (for example, by acting as a disincentive to ‘trade-up’ or ‘trade down’ as their particular circumstances change).

- The incidence of conveyance stamp duties falls mainly on householders, being reflected in house purchase costs being higher-than-otherwise; and,

- Such taxes are regressive, falling more heavily on lower and middle income, than higher income, earners, ceteris paribus.

4.32 A more recent study published by the Australian Treasury (Cao et al 2015) comes to fairly similar conclusions, using the MEB approach to assess the economic welfare costs of selected changes to the Australian taxation system.

4.32.1 That is, what is the cost to economic efficiency of raising the marginal dollar in revenue from any given tax.

4.33 The Treasury study considered the MEBs of five major taxes:

- company income tax;

- personal income tax;

- the GST;

- broad-based land tax; and,

- stamp duty on conveyances of structures (for example, commercial and residential property).

4.34 Amongst the main overarching findings of the Treasury study were:

- the main taxes used in Australia to raise revenue result in losses in economic efficiency by distorting price signals, and changing the behaviours of individuals; and,

- the incidence of Australia’s major taxes fall most heavily on labour (that is, working people) by lowering labour productivity and in turn real wages.

4.35 More specifically, the Treasury study found each additional dollar of revenue raised from:

- company income tax reduced economic efficiency by 50 cents (MEB = 0.50);

- personal income tax reduced economic efficiency by 21 cents (MEB = 0.21);

- the GST reduced economic efficiency by 19 cents (MEB = 0.19). However, this economic loss would be reduced to 17 cents (MEB = 0.17) if the current exemptions to the GST were eliminated;

- land taxes increased economic efficiency by 10 cents (MEB = -0.10; by bringing foreign holders of land into the tax net); and,

- stamp duties on the conveyance of structure, reduced economic efficiency by a whopping 72 cents (MEB = 0.72), and in some cases over MEB = 1.15 (when the conveyancing of structures was highly tax-sensitive).

4.36 Taken as a whole, the Treasury study carries the latent implication the most economically efficient beneficial taxation system would place:

- greater reliance on land taxes, and on Goods and Services taxation;

- lesser reliance on company income taxation; and,

- abolish stamp duties on conveyances of structures.

4.37 However, it is moot whether such a configuration of taxes would be the most politically efficient.

5 Taxation of Small Business

5.1 The Tax Discussion Paper (TDP; Chapter 6) reviews the arrangements for the taxation of small business, and seeks stakeholder views on options for their reform.

5.2 The TDP makes a number of sensible observations about the taxation of small business in Australia, ranging across:

- navigating a complex taxation system can be disproportionately burdensome for small business;
- while the taxation system provides concessional treatment for, these can add to the complexity and compliance burden imposed upon, small business;
- small businesses differ significantly from larger businesses – they are not just 'big business in miniature';
- small business are not homogenous in their legal or taxation forms, operating in forms such as sole trader, partnership, trust or corporation, or combinations thereof – all of which can have different tax compliance, liabilities and outcomes, for similar activities;
- the interaction of the personal (individual) and the business tax systems implicitly encourages taxpayers to adopt complex tax structures, resulting in unnecessarily onerous compliance costs for Australian businesses;
- tax compliance costs are higher per dollar of turnover for small business than they are for larger businesses; and,
- small business enjoy a range of tax benefits/concessions not available to medium to larger firms (for example, relating to GST, and depreciation), but accessing with them can impose additional compliance burdens on such businesses.

5.3 Evidence suggests the regulatory burden is becoming even more onerous for builders, particularly ‘the red tape’ burden relating to taxation administration. In Master Builders’ 2014 June quarter national survey of building and construction, respondents were asked whether”:

> *“The tax compliance burden for your business has in the past few years become: much better, better, no change, worse or much worse?”*

5.4 A majority of builders indicated that the tax compliance burden had become worse or much worse in the past few years.

5.4.1 As Table 5.1 below shows, the percentage of respondents believing the burden had become “worse” or “much worse”, ranged (by business size) from 51.6 per cent for businesses employing 6 to 10 people, to 63.8 per cent for businesses employing 11 to 20 people.

Table 5.1: The Tax Compliance Burden for Businesses in the Building and Construction Industry

The tax compliance burden for your business has in the past few years become	Small Business Size									
	1 to 5		6 to 10		11 to 20		more than 20		non-employing	
	No.	%	No.	%	No.	%	No.	%	No.	%
much better			1	0.6						
better	1	2.6	7	3.9	1	1.7			1	4.8
no change	17	44.7	79	43.9	20	34.5	14	41.2	9	42.9
worse	15	39.5	71	39.4	29	50.0	15	44.1	8	38.1
much worse	5	13.2	22	12.2	8	13.8	5	14.7	3	14.3
Total	38	100	180	100	58	100	34	100	21	100

Source: Master Builders Australia, National Survey of Building and Construction June quarter 2014

5.5 The TDP (at pages 119– 20) discusses a ‘model’ which could greatly simplify the taxation treatment of small businesses, key elements of which include:

- small business could be subject to a much lower, even zero, rate of taxation;
- this arrangement would be ‘funded’ by reducing, if not eliminating, the multiplicity of tax concessions provided to such businesses; and,
- as a result, business operators/owners would better spend their energies growing their businesses, rather than on tax compliance/reporting/ planning.

5.6 The Henry Report (Australian Government, 2009) also touched, albeit rather lightly, on the taxation of small business, largely in the context of small businesses as 'clients' of taxation agencies, and Standard Business Reporting (see Section G1 – dealing with tax accountability)

5.7 Master Builders has an open mind about the 'zero rate' proposal, subject to:

- the composition and nature of the overall package involved (that is, the tax concessions being 'traded-off' for the reductions in the tax rate); and,
- there being an overall reduction in the tax burden carried by small business – that is, they be net better off as a result of the new package.

6 Goods and Services Tax

6.1 The TDP (Chapter 8) reviews the design and operation of the GST.

6.2 Key features of the Australian GST model include:

- the State and Territory Governments receive all of the revenue raised by the GST (which accounts for just under one-quarter of their total income);
- the GST is fairly efficient tax, relative to other taxes collected in Australia;
- only 47 per cent of the potential taxable base of goods and services is subject to the GST, the balance being exempted (eg fresh food, education, health, childcare);
- however, its efficiency is compromised, and complexity is increased, as a result of the various exemptions (which can add to administrative costs for business);
- the system of GST exemptions is a relatively costly and inefficient form of social policy, which could be better achieved by more effective targeting of assistance to lower income households;

- while businesses may act as the agents for taxation authorities in the collection of the GST, ultimately the tax is passed onto and paid by consumers; and,

- most individuals pay similar amounts of GST as a proportion of their incomes across their life cycles (implying the GST is not necessarily regressive when viewed through a wider lens).

6.3 The TDP makes abundantly clear the parameters within which the Federal Government could consider and/or pursue any changes to the GST when it says (at page 131):

> *“… interested parties are welcome to put forward proposals to change the GST.”*
>
> *“However, the Australian Government will only consider progressing any such proposals if there is a broad political consensus for change, including agreement by all state and territory governments.”*

6.4 Regrettably, issues relating to the GST were expressly carved out of the terms of reference for the Henry Report (Australian Government, 2009).

6.4.1 However, it would not be unreasonable to presume the Henry Report, had it been allowed to consider the matter, would have come to much the same conclusions and findings as the current Tax Discussion Paper.

6.5 Master Builders has an open mind about reforming the GST (both as to coverage (exemptions) and to the applicable rate), subject to:

- the composition and nature of the overall package involved (in particular, the ‘trade-offs’ involved); and,

- there being an overall reduction in the tax burden imposed upon consumers, and compliance burden carried by business (as de facto agents of tax authorities) – that is, they both must be net better off as a result of the new package.

7 Land Taxes/ Stamp Duties

7.1 The TDP (at page 151) seeks stakeholders' views on the priorities for reform of State and Local government taxes, including stamp duties and land taxes

7.2 The TDP makes a number of sensible observations about the operation of stamp duties (at pages 144 to 147) and land taxes (at pages 147 to 148) within the Australian taxation system.

7.3 On stamp duties, these include stamp duties:

- are some of the most inefficient taxes in Australia;
- are particularly vulnerable to tax avoidance, as they discourage consumption of the goods or services concerned;
- on residential and commercial property are important sources of revenue for State and Territory Governments;
- on commercial property transactions can discourage business from undertaking property land developments and/or exchanges, and constrain land holdings to relatively unproductive uses; and,
- on residential property transactions can discourage consumers/householders from choosing housing options which best suit their needs, and can reduce labour mobility.

7.4 On land taxes, these include:

- the land tax base in Australia is fairly narrow, given the wide range of tax-free thresholds and exemptions;
- more than half of the potential land tax base, by value, is effectively immune from taxation because of such thresholds and exemptions; and,
- as such, the current land tax regime in Australia is fairly inefficient.

7.5 The TDP largely echoes the findings of the Henry Report (Australian Government, 2009) on both stamp duties and land taxes.

7.6 On stamp duties, the Henry Report observed (at pages 247 to 270 inclusive), inter alia:

- stamp duties are poor taxes (in the context of their inefficiencies); and,
- they are inconsistent with the needs of a modern taxation system.

7.7 On land taxes, the Henry Report observed (ibid), inter alia, land taxes:

- are efficient taxes, and have the potential to be sustainable forms of revenue for State and Territory Governments;
- should not discriminate between the owners of the land, or the uses to which the land is put;
- any land taxes (either expanded or new) should be based on the unimproved value of the land;
- they should not include the value of any buildings located thereon, or be activated by any transactions of the land or buildings concerned; and,
- there should not be any variations in exemptions or variations, with equity considerations being handled through other channels.

7.8 Master Builders recognises there could be fiscal and economic merit in moving from the current stamp duty-based to a broad land tax based system of property taxation, within robust and comprehensive programs of taxation reform at the State and Territory levels of government.

7.9 Master Builders is open to a conversation on the options for transitioning from stamp duties to land tax-based approach to commercial and residential property conditional on a number of factors, namely:

- stamp duties on land and building transfers and existing land taxes be abolished;

- land valuations must be fully indexed for price inflation so only real (that is, above inflation) increases in land values are subject to the land tax;
- the land tax be set and applied at a single, flat rate;
- there are minimal, if any, exemptions from the land tax, and where exemptions are allowed they be transparent and for limited periods only (not in perpetuity);
- be applied on an per square metre of land, regardless of use to which the land is put;
- be applied on a per land holding (not an aggregation) basis;
- the new system be revenue-neutral (that is, resulting in no net increase in revenue);
- the new system be designed and implemented as a harmonised, nationally-consistent single model; and,
- delivered as an overall package ('all or nothing'), with the State and Territory Governments to give a 'single undertaking' on all of the elements set out above, without exception.

8 Housing and Superannuation

8.1 The TDP examines the taxation treatment of superannuation, and its place within Australia's broader retirement incomes policy framework (at pages 67 to 70 inclusive).

8.2 In this review, the TDP observes, inter alia:

- superannuation is a key pillar of Australia's retirement income system;
- superannuation contributions generally enjoy more favourable tax treatment than other forms of saving;

- the efficiency and equity of the tax treatment of superannuation needs to be considered in the wider context of Australia’s full retirement incomes support arrangements;

- compulsory superannuation savings have made a significant contribution to raising the national savings rate in Australia, and is likely to continue to do so well into the foreseeable future; and,

- the majority of superannuation savings are held in accumulation funds, where the ultimate retirement benefit is the outcome of contributions made, earnings accrued and fees paid over the period of the investment.

8.3 The TDP does not, of itself, expressly consider the investment strategies of the superannuation industry, such as how the funds-under-management should be invested.

8.4 Nevertheless, the Federal Government (Hockey, 2015) has signalled it is willing to consider allowing superannuation fund holders to access their superannuation for purposes such as purchasing a principal residence and/or skills training.

8.5 The Australian Treasury has examined allowing superannuation withdrawal for residential housing (Treasury, 1997).

8.6 The study, inter alia, examined the general arguments for and against, and undertook some focused econometric modelling of, such a proposal.

8.7 The econometric model focused on a hypothetical young couple, with each member of the couple being allowed to withdraw $15,000 from their own superannuation account with the amount being taxed on a concessional basis (as an Eligible Termination Payment).

8.8 In broad terms, the Treasury found:

- for any given superannuation withdrawal (for a non-retirement income purpose), the earlier the individual obtains access to their funds the greater is the reduction in the real value of their retirement benefit (a compound interest effect);

- this lower retirement income, excluding housing, is likely to mean a lesser standard of living in retirement, with the detrimental effect likely to be greater for lower than for higher income earners; and,

- allowing superannuation withdrawals, in all cases, results in an increased cost to taxpayers for aged pension support.

8.9 The Treasury concluded:

> *"… it is unclear that allowing people access to their superannuation for housing will significantly increase the numbers of people who ultimately achieve home ownership, though it can be expected to have a small positive impact."*
>
> *Whatever targeting arrangements are adopted, any such scheme is likely to be accessed by a significant number of individuals who would have achieved home ownership prior to retirement in any event, with the result they will be able to either purchase a more expensive home or reduce their non-superannuation saving for housing."*

8.10 Master Builders Australia opposes allowing superannuation account holders to obtain early access to their funds for other than rare and exceptional circumstances (such as serious or terminal illness). 'Rare and exceptional circumstances' do not include financing education, housing or business development.

8.11 Rather Master Builders' holds strongly the view the sole purpose of Australia's national system of compulsory superannuation is to optimise the returns in retirement incomes for superannuation account holders.

8.12 Nevertheless, Master Builders' shares the concern of many in the community and in the building and construction industry at the substantial hurdles confronted by, for example, new/younger home buyers looking to enter the owner-occupied residential housing market.

8.13 The better approach to, and higher priority for, improving access to owner-occupied residential housing for all Australians is decisive action to tackle the wider problem of housing unaffordability – by delivering Master Builders Australia's Action Agenda on Housing Affordability.

8.14 Key elements of our Action Agenda on Housing Affordability are:

- having an efficient housing market, achieved by substantially reducing, if not eliminating, supply-side impediments;
- the development and annual reporting of key performance indicators of housing market efficiency, by/for Federal, State/Territory and Local Governments, individually and collectively;
- local governments develop and publish annually individual, and comparable, Land Release Plans identifying land which would be 'release ready' over a rolling 10 year ahead time frame;
- all governments commit to and champion a national uniform and enforceable national building code and regulatory system;
- the introduction of more efficient and market-responsive planning and related approvals processes;
- the progressive and sustained reduction, leading over time to the elimination, of stamp duties on residential property; and,
- the elimination of inefficient and unjustifiable infrastructure (also known as developer) charges on property developments.

9 Negative Gearing

9.1 The TDP (at page 66) seeks stakeholders' views on the impact of 'negative gearing' on savings and investment outcomes.

9.2 The TDP makes a number of important observations (at pages 63 to 55 inclusive) about the operation of 'negative gearing' within the Australian taxation system. These include:

- the tax treatment of investment in real estate is the same as that for investment in any other asset which produces current incomes and capital gains;
- many of the reasons people invest in residential property rather than other assets have little to do with taxation;

- negative gearing of itself does not cause a tax distortion;

- negative gearing allows more people to enter the asset market (for example, residential property) than would otherwise be the case (for example, if they relied on equity funding alone);

- negative gearing promotes consistency of treatment between debt and equity funding (through its treatment of interest expenses); and,

- any taxation advantages for individuals investing in residential property does not come from borrowing (that is, negative gearing) but rather from the tax treatment of any capital gains on the asset concerned.

9.3 The landmark Henry Report (Australian Government, 2009) also examined the issue of the application of 'negative gearing' arrangements to housing supply and affordability, concluding (at page 418), inter alia:

- changing the taxation of investment properties could have an adverse impact in the short to medium term on the housing market; and,

- changes to the tax treatment of investment property should only be adopted following reforms to the supply of housing (for example, land release policies).

9.4 Taken as a whole, the Henry Report concluded (at page 420):

> *"A range of other policies are likely to have a more significant impact on housing supply than tax settings.*
>
> *The tax system is unlikely to be an effective instrument to move housing prices toward a particular desired level and the tax system is not the appropriate tool for addressing the impact of other policies on housing affordability."*

9.5 Federal Government must provide certainty to investors in housing stock, of whatever form, on the tax treatment of such investments, in particular, the preservation of 'negative gearing' of residential housing stock.

9.6 Master Builders’ regards ‘negative gearing’ as a vital element for ensuring supply of more affordable residential housing for lower income earners and for those who elect to rent as a life-style choice.

9.7 Econometric modelling undertaken by Master Builders has estimated negative gearing accounts for:

- between 9 and 11 per cent of new housing supply each year, or
- more than 41,200 new dwellings in the 2014 and 2015 financial years, and
- homes for just over 104,000 people in those two years alone.

9.8 Without an effective ‘negative gearing’ arrangement the supply of rental properties would be lower, and/or the rents charged for available rental properties would be higher.

9.9 Similarly, absent ‘negative gearing’ there would likely be substantial additional fiscal pressure on Federal, State/Territory and Local Governments to:

- directly provide public-rental housing (thus taking on a greater hands-on role as landlord); and/or,
- provide additional financial assistance to meet the higher (non-subsidised) housing costs carried by socially disadvantaged members of society.

9.10 Master Builders endorses the Henry Report’s conclusion it would be premature to unsettle existing taxation arrangements before concrete action was taken to address wider problems of housing affordability and supply.

10 Capital Gains Tax

10.1 The TDP considers the taxation of capital gains at various places throughout the Paper, both in the context of personal and business (especially small business) taxation.

10.2 The TDP points out, on capital gains tax (CGT), inter alia:

- CGT is a form of income tax, levied on the ‘net capital gains’ made by the taxpayer at their applicable rate (general for business; marginal for individuals);

- ‘net capital gains’ means capital gains can be offset again capital losses for the purpose of determining tax liability;

- CGT is only paid on a realisation basis – that is, when the asset concerned is sold or transferred;

- GST is subject to a number of concessions and exemptions, such as:

    - for individuals, the most important is the general ability to discount a realised capital gain by 50 per cent if they have held the asset for more than one year.

    - for small businesses, as for individuals, but also in certain circumstances where the owner is aged more than 55 years and is retiring, or the funds from the realisation of a capital asset are being used to replace or upgrade existing business assets.

- Such concessions can add to the complexity of the taxation system, and discourage small businesses from growing (given these arrangements are not available to larger firms).

10.3 The Henry Report (Australian Government, 2009) considered at length CGT issues, both for individual and for business taxpayers.

10.4 On CGT, the Report found (at page 80):

- CGT rules applicable at the time were particularly complex; and,

- such complexity is compounded by the various exemptions, and ‘grandfathering’ arrangements.

10.5 The Report (at page 80) recommended the CGT regime be simplified by, inter alia:

- rationalising and streamlining CGT concessions for small businesses;

- eliminating the grandfathering provisions of the CGT regime applying to assets acquired before the commencement of the CGT; and,

- more closely integrating the CGT regime into the broader income tax system.

10.6 Master Builders' advocates the introduction of a reducing stepped rate of capital gains. This would reduce the CGT burden and encourage longer-time horizon investment as well as discourage speculative investments.

10.7 Assets held for:

- less than 1 year have 100 per cent of CGT subject to tax;
- 1 to 2 years have 50 per cent of CGT subject to tax;
- 2 to 5 years have 25 per cent of CGT subject to tax;
- 5 to 10 years have 10 per cent of CGT subject to tax; and
- more than 10 years have 0 per cent subject to tax (that is, CGT free).

10.8 Such an approach would greatly stimulate investment in assets which would broaden and deepen Australia's productive capital base, and through this our national competitiveness and productivity.

11 OECD Report

11.1 A report published recently by the OECD (Hemmings and Tuske, 2015) contains several key messages which have particular resonance for the Australian Tax White Paper processes.

11.2 Key amongst these messages are:

- tax system design should emphasise the economically least damaging taxation measures necessary to raise revenue;
- there is a need to shift the tax balance away from the current reliance on direct (income) taxes, towards greater reliance on indirect taxes (such as the GST);
    - this objective could be achieved by, inter alia, reducing the number of zero rates and exemptions applying to the GST;
    - such rates and exemptions are a poor tool for assisting low income households; and,

  - any reforms to the GST system would need to be co-ordinated with reforms of federal-state financial relations;

- if left unchecked, tax (and benefit) systems tend to become more complex, and the political costs of reform become greater, with time;

- tax reforms have to be considered alongside benefit reforms (for example, social and business assistance programs), as it is the net effects from packages-as-a-whole which matter (as distinct from the various components);

- tax avoidance strategies tend to increase with the tax burden, and compliance obligations;

- stamp duties on residential property should be reduced or eliminated; and,

- Australia's relatively high headline rate of corporate tax (at 30 per cent) does not help promote the nation to foreign investors.

11.3 Specifically, the Report recommends, in terms of rebalancing the direct/indirect tax mix:

- making greater use of GST by reducing preferential treatment and by raising the rate;

- increasing personal-income tax thresholds and reducing rates in the medium term;

- reducing transactions taxes on housing and consider greater use of recurrent taxes on property; and,

- lowering the rate of corporate tax through a series of staged rate cuts over several years.

12 Conclusion

12.1 The building and construction sector is one of the most intensely taxed in Australia, and bears a direct and indirect tax burden from all levels of government — Federal, State and Territory, and Local.

12.1.1 This high and onerous tax burden distorts investment decisions, discourages entrepreneurship and innovation, reduces business investment and employment opportunities, and diverts scarce resources into unproductive and unnecessarily costly tax compliance within a key sector of the Australian economy.

12.2 More needs to be done to ensure the tax system rewards entrepreneurship and reduces compliance costs for business particularly small business. The Federal Government’s current tax review is an opportunity to lay down a pathway to achieve a more efficient taxation regime in Australia.

12.3 Master Builders’ tax reform agenda calls for:

- a comprehensive review of the narrow GST base;
- any increase in the GST rate must not be undertaken without first effecting comprehensive tax reform;
- reducing the company tax rate to 25 per cent;
- reducing the differential between the higher marginal personal income tax rates and the company tax rate;
- simplifying tax compliance, especially for small business to free up entrepreneurial energies for more productive purposes, such as generating investment, employment and productivity;
- providing incentives for the removal of inefficient state taxes including infrastructure taxes, charges and levies;
- introducing a reducing, stepped rate of capital gains tax; and,
- retaining the tax exempt status of home ownership and negative gearing;

12.4 Master Builders calls for a holistic approach to tax reform.

12.5 Measures must not be considered in isolation or as single issue trade-offs, or in response to short term fiscal pressures. Rather, the final Tax White Paper must be a comprehensive, detailed, and specific ‘blueprint’/package, for the medium to longer term.

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