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Executive Summary

Restaurant & Catering Australia is the only peak national organisation representing the interests of the 40,000 restaurants cafes and caterers in Australia.

The industry turns over some \$15 Billion per annum. The last four months of the 2007/08 financial year were consecutive months of negative growth with June 2008 being 5.3% down on June 2007. Business are reporting (through 6 monthly benchmarking reporting to R&CA) there has been a downturn on 2007 levels in September / October 2008¹ and 71.2% of businesses reported that their turnover by years end would be less or the same as 2007.

Whilst revenues have not hit 'crisis' levels there is a significant softening in the market with 34% of businesses expecting to reduce staffing hours or numbers over the next 12 months. The industry maintains that cuts to barriers to spending would be as effective as providing payments to stimulate spending. Cuts in taxation, particularly taxation that is linked to spending (such as FBT) would focus spend in areas that are labour intensive and effective in stemming increases in unemployment.

Restaurant & Catering Australia considers that significant reform should be undertaken to the administration of the tax system, especially around the impact of tax administration on business. R&CA believes that a mechanism should be established that focuses on effective tax administrative process for industry sectors, modelled on the industry partnerships that were functional over the period of the GST implementation. Specific administration issues to be dealt with should include GST in relation to deposits, cancellation, and Tips.

The Association has a deep concern over the proposed legislation on component pricing in relation to its application to restaurant menus. R&CA believes that component pricing legislation provide explicit clarification that 'a restaurant menu is not an advertisement' and therefore not subject to component pricing requirements of the Trade Practices Act.

Capital Gain Tax Reform and making FBT more fair and practical are two priorities for the restaurant industry. R&CA recommends the removal of the Lifetime limit of \$500,000 for super roll over of CGT, with unconditional business to business CGT roll over and the ability to offset income losses against capital gains and some practical measures on GCT.

On Fringe Benefits Tax, specifically on business meals, the Association recognises the complexity of the current arrangements and recommends that legitimate business meals be removed from the FBT net and all meals be made non-deductible.

Reduction of State Taxes (particularly payroll tax) and the effective taxation of employers investment in training and education are also areas in which the tax system could improve for restaurants, cafes and catering businesses.

Service businesses such as restaurant and catering businesses bear a significant tax burden due to their labour intensity and their customer facing nature. They bear the brunt of the PAYG system in that they lodge PAYG for a greater proportion of their revenues than other businesses.

R&CA provides the suggestions in this submission as ways in which this potentially high growth industry could be better placed, through the taxation system to better meet the economic and environmental challenges of the 21st century.

¹ ABS have changed the format for Retail Trade data making a comparison of data across 30 June 2008 impossible.

Restaurant & Catering Australia

Restaurant & Catering Australia (R&CA) is the peak national organisation representing the interests of restaurateurs and caterers.

The Association is a federation of Industry Associations that work together on matters of national importance. The Industry Associations had a combined membership of over 6,500 in the last calendar year. There is an R&CA member restaurant and catering association in every State and Territory.

The Restaurant Industry

In 2004 the Australian Bureau of Statistics reported 37,699 restaurant, café and catering businesses² that are registered for GST. Of these businesses, 89% employ 20 people or less. There are 124 businesses Australia wide that employ in excess of 200 people³. In the broader accommodation, cafe and restaurant industry 75% of employing businesses employ less than 20 people (Figure 1 below).

The Business Register records 68,022 businesses in the total accommodation, cafes and restaurant sector (including hotels, pubs and clubs). Restaurants, cafes and catering businesses account for 55.4% of the hospitality industry by numbers of businesses.

Whilst the reporting of numbers of businesses in the restaurant sector alone has not been repurchased from the ABS, the overall numbers of businesses in the accommodation, café and restaurant sector have grown by 2.1%, 1.8% and 1.8% each financial year from 2004/05 to 2006/07⁴. It is expected conservatively that there were 39,888 restaurants, cafes and caterers in Australia in 2007.

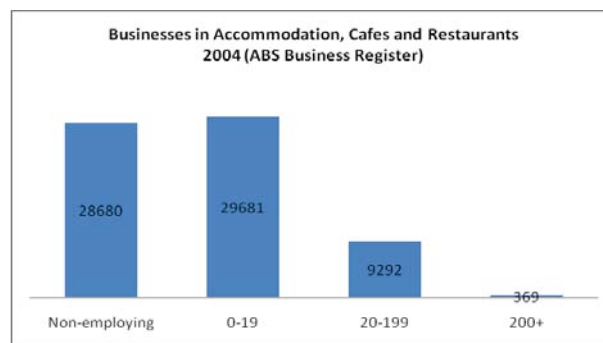


Figure 1 – Hospitality Businesses by Employment Number, 2004

The last four months of the 2007/08 financial year were consecutive months of negative growth with June 2008 being 5.3% down on June 2007. Businesses are reporting (through 6 monthly benchmarking reporting to R&CA) there has been a downturn on 2007 levels in September / October 2008⁵. One quarter of businesses are expecting to be 10% or more down on 2007 revenues by the end of 2008 and a further 25.7% expect to be between 0 and 10% down.

Whilst revenues have not hit 'crisis' levels there is a significant softening in the market with 34% of businesses expecting to reduce staffing hours or numbers over the next 12 months.

² ABS Business Register 2004, Unpublished purchased by R&CA

³ *Ib id*

⁴ 8161.0.55.001 Australian Bureau of Statistics Business Register, Counts of Businesses

⁵ ABS have changed the format for Retail Trade data making a comparison of data across 30 June 2008 impossible.

Turnover for the 2007-08 year was \$15.56 Billion for cafes and restaurants compared to \$13.59 Billion in the 2006-07 year. In recent years turnover was most positively impacted by October – December 2007 that was the strongest trading performance for the industry ever.

A report released by the Australian Bureau of Statistics⁶ in April 2008 shows a slowing in restaurant profits (as forecast by the R&CA) with over 50% of businesses (the businesses employing less than 0-4 people) generating an average LOSS of .03%.

Businesses reported to the ABS restaurants had an average net profit of 3.8%, down 5% on the previous survey period (2004-05). Labour costs have risen an average of 10% from in the same period, with turnover growing by 9.2%. Meals consumed in restaurants income grew by 6.2% with the major increases coming from takeaway and liquor sales.

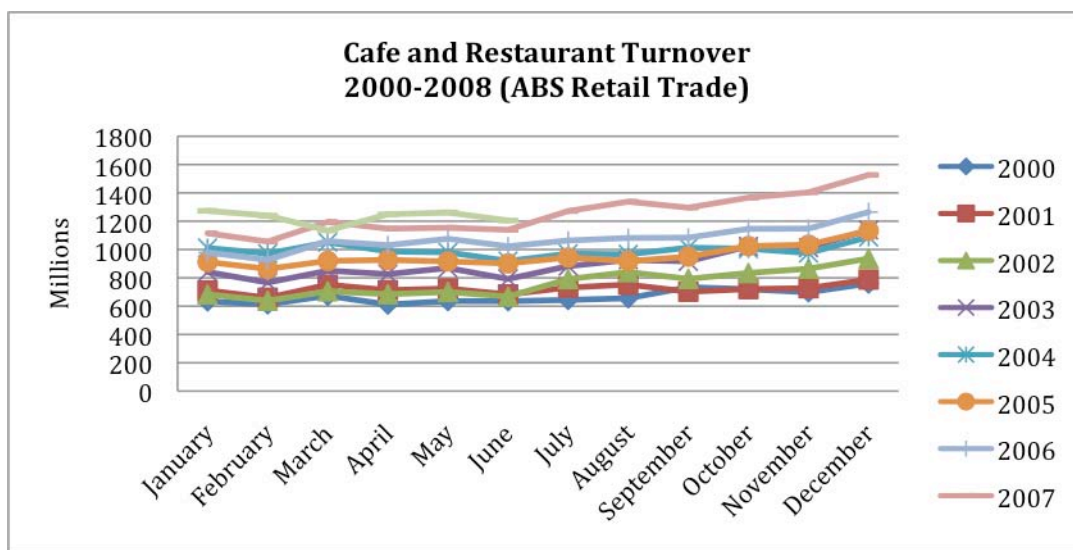


Figure 2 - Restaurant Industry Turnover 2000 - 2008

In the period between the December Quarter 2006 and that of 2007 the price of restaurant meals increased by 3.8%⁷. In the same period the price of food inputs to restaurants rose by an estimated 4.2% based on the combination of food inputs to restaurants (Dairy products by 9.1%, Bread and Cereal by 5.4%, Meat & Seafood by 3.2% and Vegetables by 8.6%).

⁶ Cafes and Restaurants Industry Survey, ABS 8655.0

⁷ ABS, Consumer Price Index, 6401.0, December Quarter 2007

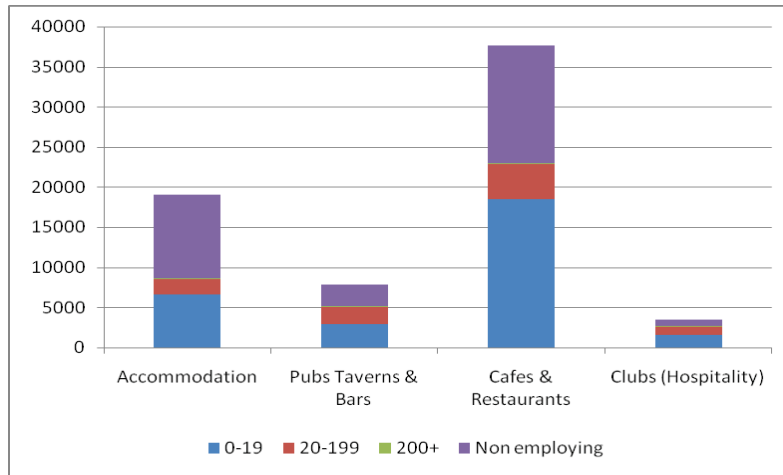
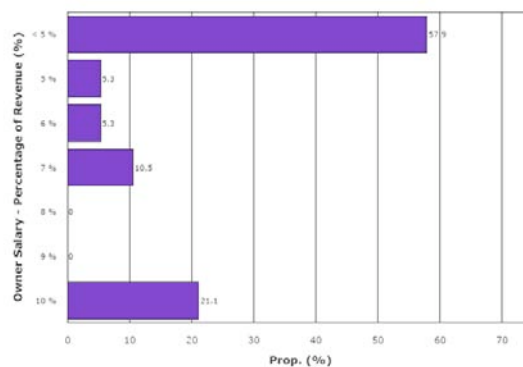


Figure 3 – Proportion of the Hospitality Industry by Sector and number of employees

There are 20,500 working operators in the restaurant and catering industry in Australia. In a recent CCH Benchmarking of restaurant businesses results showed average return for operators of \$42,000 for 54 hours work.

In early 2008 Restaurant & Catering Australia undertook a benchmarking survey in conjunction with the AEC Group. AEC reported (as detailed below) that the average owners salary was 4.87% of revenue. If based on the Australian Bureau of Statistics Average revenue for restaurateurs and caterers the owners this would equate to \$43,174.00 per annum. This is close to the CCH figure.

Owner Salary – % of Revenue

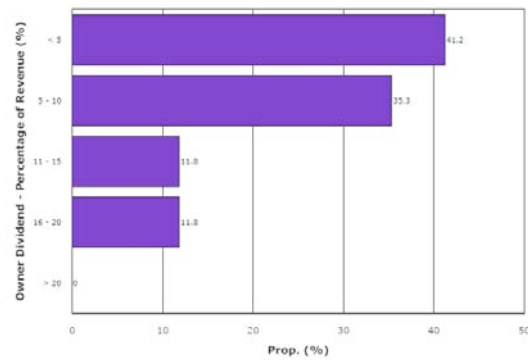


• Average – Owner Salary as % of Revenue – 4.87% (w/a)

Figure 4 - Owners Salary as a Proportion of Revenue

The total owners dividend from the business (including salary) was a weighted average of 7.5%. This would be \$66,489. An additional \$23,315 would be drawn from the business on average each year.

Owner Dividend - % of Revenue



- Average – Owner Dividend as % of Revenue – 7.50% (w/a)

Figure 5 – Owner Dividend as a % of Revenue

Service businesses such as restaurant and catering businesses bear a significant tax burden due to their labour intensity and their customer facing nature. They bear the brunt of the PAYG system in that they lodge PAYG for a greater proportion of their revenues than other businesses. Similarly, in relation to GST, as restaurants, cafes and caterers are all customer facing they collect GST and only claim input credits on a proportion of their inputs (as the majority of inputs are wages).

The bi-annual R&CA Benchmarking survey probes the compliance cost of GST. Restaurateurs and caterers estimate that GST administration costs are in the order of \$240 per month. In addition areas of particular concern are administration of the Superannuation Guarantee Levy, PAYG and income tax.

The Review

It is understood that the review of Australia's tax system will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia's economic and social outcomes.

It is understood the review will consider:

- The appropriate balance between taxation of the returns from work, investment and savings, consumption (excluding the GST) and the role to be played by environmental taxes;
- Improvements to the tax and transfer payment system for individuals and working families, including those for retirees;
- Enhancing the taxation of savings, assets and investments, including the role and structure of company taxation;
- Enhancing the taxation arrangements on consumption (including excise taxes), property (including housing), and other forms of taxation collected primarily by the States;
- Simplifying the tax system, including consideration of appropriate administrative arrangements across the Australian Federation; and
- The interrelationships between these systems as well as the proposed emissions trading system (ETS).

Restaurant & Catering Australia makes recommendations below in light of the scope of the inquiry and the current environment in which the industry operates. Many of the points raised have been covered in prior submissions and further detail can be provided if required.

The Q4 2008 Outlook

The restaurant and catering industry is facing, along with the rest of the Australian economy, a fairly bleak 2009/10. Whilst the industry is keen not to make a recession a self-fulfilling prophecy by talking the market down, in the content of a submission such as this, R&CA has chosen to provide frank analysis.

In a survey of restaurants, cafes and caterers in October 2008, 57% of businesses reported September and October turnover to be lower than 2007 and 71.2% of businesses reported that their turnover by years end would be less or the same as 2007.

Looking forward to the next 12 months 48.9% of businesses suggested they would be employing less people, 50% said they would be increasing prices and 68.2% said they would be less profitable.

Whilst the spending stimulous arrangements, such as those introduced recently in response to the 'financial crisis', are important responses in an environment in which we find ourselves, the R&CA suggests that spending should be even more tightly targeted and, in addition, measures (such as those proposed in this paper) that would remove barriers to spending should also be addressed.

In relation to more tightly targeting spending, R&CA believes that the Government should look to encourage spending that has the most exaggerated employment effect. That is the most labour intensive sectors would be the target of spending stimulous so as to have the greatest impact of job retention.

Tax Administration

There are several areas of tax administration that cause grief to restaurateurs and caterers. In addition, from a tax administration planning perspective, the Association shares many of the operators frustrations with the management of the tax system.

The process through which rulings and fact sheets are developed, in spite of feedback from industry, is difficult to understand. The result of the disconnect between business and the tax system leads to situations such as that surrounding the GST on Deposits Ruling (GSTR 2006/2), the Cancellations Draft Ruling (GSTR 2008/D4), the situation with GST on Tips and many other issues.

In 1999 and 2000 at the time of GST implementation, a series of consultative groups was formed to assist with GST administration. These groups worked effectively to develop practical arrangements whereby industry could comply with the rulings as drafted. These groups have continued but are substantially dysfunctional. In the R&CA's view, these groups should be reconstituted as substantive industry consultation arrangements by the ATO.

Recommendation

- **That the ATO reconstitute substantive industry consultation arrangements.**

GST on Tips

The lack of clarity to the treatment of Tips for GST purposes is a live issue for Australia's restaurateurs (and in fact all hospitality businesses). It is understood that there has now been a determination in relation to the GST on tips, however, the determination has not been published and despite several requests over the past 8 years, no advice is able to be provided to restaurateurs.

GST on Security Deposits

One of the major policy issues for the industry, in particular caterers is the GST on Security Deposits – This issue is very poorly understood by restaurateurs and caterers. When the GST was introduced restaurateurs and caterers generally paid GST on the part of a deposit that was paid and then on the balance when the account was paid by the customer.

R&CA is aware that the Commissioner has issued a Determination which applies in situations where a supply occurs before the supplier knows the total consideration. This is A New Tax System (Goods and Services Tax) (Particular Attribution Rules Where Total Consideration Not Known) Determination (No. 1) 2000, contained at Schedule 5 of GSTR 2000/29.

However, in the present situation, the supplier knows the total consideration when the supply occurs, hence that Determination is not relevant.

We are also aware that the Commissioner has already issued a Determination in respect of supplies for which payment is made or an invoice is issued, but use, enjoyment or passing of title will, or may, occur at some time in the future. This is the A New Tax System (Goods and Services Tax) Act 1999 (Particular Determination Rules for Lay-By Sales) Determination (No. 1) 2000, contained at Schedule 1 of GSTR 2000/12 ("the Current Determination").

The current Determination has a restricted application since it is confined to supplies of goods made under a lay-by sale agreement, as defined. However, paragraph 29-25(2)(b) of the GST Act, under which the *Current Determination* was made, can include circumstances which involve supplies of real property or things other than goods or real property, where the use or enjoyment of those supplies will occur some time after a payment is made or an invoice issued.

It is our submission that there is a need for a further determination under paragraph 29-25(2)(b) of the GST Act to cover a further range of circumstances where the application of Division 29 and Chapter 4 is inappropriate.

Component Pricing

The Association has a deep concern over the proposed legislation on component pricing in relation to its application to restaurant menus. Restaurant & Catering Australia maintains that restaurant menus should be explicitly excluded from the requirement to state 'as a single figure, the single price'.

A menu by definition is 'a list of items to be served at a meal¹'. It therefore represents the 'components' of a meal. The purpose of a menu is therefore contrary to the 'single figure price' doctrine.

The thrust of the Trade Practices Amendment (Component Pricing and Other Measures) Bill 2008 is to rectify the fact that section 53C of the Trade Practices Act 1974 (Cth) does not prohibit all forms of component pricing and that its provisions are not sufficient to satisfy the desire to facilitate the ability of consumers to 'easily compare prices'.

Restaurant & Catering Australia contends that a menu is specifically designed to list the components of a meal and therefore should list all the components at their price. The comparison of menu items by the consumer is undertaken at the restaurant (and not between restaurants as an all up price for a meal).

Restaurants therefore should not be subject to moves toward requiring the statement of as a single figure, the single price.

Recommendation

- **That component pricing legislation provide explicit clarification that 'a restaurant menu is not an advertisement' and therefore not subject to component pricing requirements of the Trade Practices Act 1974 (Cth.).**

State Taxation

Restaurant & Catering Australia believes that the Australian Government should drive, through the tax reform process, the rationalisation of taxes nation-wide. This process should not exclude the rationalization of State Taxes as a large slice of revenue is now distributed to the States through the GST.

In particular the Federal Government should facilitate additional revenues to the States to offset payroll tax, with a reduction of this revenue over time as the GST increases make up for the payment required.

At a time where the protection of employment is paramount (as a key mechanism to fend off recessions), a tax on employment is even less tolerable.

The service sector (now 82% of employment) now bears the brunt of the payroll tax burden. As labour intensive businesses, they more quickly reach the thresholds in place. Restaurants, cafes and caterers are prime examples of businesses that face a significant impost through Payroll Tax.

Training and the Tax System

Restaurant & Catering Australia believes that the taxation system should be used to encourage the investment in training by employers. The R&CA contends, however, this should be done by using a 'carrot rather than a stick' and that employers that invest in training should be rewarded for doing so.

Restaurant & Catering Australia suggests that just as innovation is rewarded with a tax concession, training should earn a tax credit of over 100% (say 150% deductible).

Recommendations

- **That the Australian Government facilitate additional revenues to the States to offset payroll tax**
- **That a tax offset / credit be applied to investment in training**

Capital Gains Tax

Australia's capital gains tax system is well understood to be uncompetitive. Australia's top personal CGT rate is 24.3 percent for assets held more than one year which makes for the eighth highest CGT on shares held between one and two years (the OECD average is 15.2 percent) and the seventh highest CGT on shares held for ten years (OECD average is 14.0 percent). The averages are low because eleven of the OECD countries impose no CGT on shares.

One of the major issues, in relation to Australia's uncompetitiveness in relation to capital gains tax, is the predominance of small businesses in Australia. In order to be more competitive, the tax system should recognize the way in which small business uses capital. In general small, low capital intensive businesses (average capitalisation in restaurants is \$92,000) will buy and sell businesses rolling capital from one business to another (or retiring debt predominantly through repaying capital in their family home).

The capital that these businesses accumulate is the working proprietor's superannuation. They are relying on the sale of their business to pay for their retirement. This means that Government will pay through the welfare system for CGT collected on the sale of small businesses.

This practice is acknowledged to some extent in the provisions enabling a super roll over to a lifetime limit of \$500,000 for small business. R&CA contends that this lifetime limit should be removed. This would not only make the roll over easier to administer, it would encourage greater retirement savings.

R&CA also proposes that the CGT roll over from business to business should be unconditional. This provision should also allow for a deferral subject to purchase of another business⁸.

Recommendations

- **Remove the lifetime limit of \$500,000 for super roll over of CGT;**
- **Allow unconditional business to business CGT roll over with a deferral period from one business to the next;**
- **That small businesses are able to offset income losses against capital gains.**

⁸ bearing in mind that many business owners take leave between selling a business and buying the next.

Some small restaurant and catering businesses also realise a capital gain at the same time as net income losses. Whilst it is understood that offsetting gain against income losses may not be allowed for small businesses. This current practice creates arbitrage around capital sale and income in the sale event.

R&CA considers that it is important to revisit and improve on the CGT reforms introduced in 1999. We particularly consider that the Government should seriously consider introducing a stepped rate CGT, where the proportion of the capital gain that is taxed diminishes over time.

Fringe Benefits Tax

Restaurant & Catering Australia also agrees with the Australian business community in relation to fringe benefits tax. In 2006, the Institute of Chartered Accountants said that the case has never been stronger for an overhaul of Australia's Fringe Benefits Tax (FBT). The Institute called on the Australian Government to reform the FBT, which it suggested was fraught with increasing complexities, economic inefficiencies and tax inequities. The recommendations were released in a report jointly produced by the Institute and Associate Professor Neil Warren from Atax, Faculty of Law, University of New South Wales.

Since the huge downturn in commercial business in 1987 when FBT was introduced on business meals, the restaurant & catering industry has been advocating a way to get business back to the dining table. The imposed disincentive to dine out was compounded upon the introduction of GST due to input credits not being able to be claimed on business meals. The GST was tagged 'not a tax on business' but it was a tax on business meals.

There are three key problems with the current legislation, as follows:

- It does not recognise that business meals are legitimate, necessary business costs;
- It results in the over-taxation of all but those on the top marginal tax rate;
- It is very complex and leads to very high compliance costs.

Even though most meal expenses are a genuine cost of doing business, they incur FBT. Not allowing a deduction of meal expenses at the same rate as other legitimate business costs, distorts the economy. FBT at 45% over-taxes 98% of the Australian population.

Not only is Australian FBT system unfair, it is increadably complex. There are 39 different ways of treating a business meal for taxation purposes. Small businesses use hotels, restaurants and cafes as their boardroom. The very businesses that can not afford additional taxation or being disadvantaged.

Recommendations

- **Remove business meals from FBT and make all business meals non-deductible**