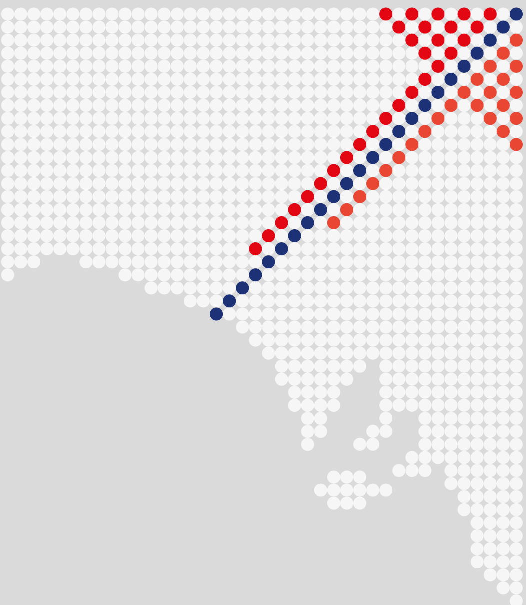
Taxation Focus Paper
Charter 2018

Payroll Tax



Business SA
Chamber of Commerce
and Industry South Australia

02 Introduction

Business SA members consistently tell us that payroll tax is a significant disincentive to employing in South Australia, particularly for small businesses just under the existing $600,000 wage threshold, which is the lowest in Australia and significantly less than Queensland's $1.1 million. While our 4.95% rate is more competitive, we remain above both Victoria and Queensland at 4.85% and 4.75% respectively.

The State Government needs to collect adequate revenue to fund high quality essential services such as healthcare, education and law and order, but that revenue must be collected in a manner which has the least impact on jobs and economic growth.

According to several government tax reviews, including the wide-ranging federal 2010 Henry Tax Review and 2015 Tax White Paper[1] land tax and the GST are analysed as the most efficient of all state and federal taxes, with other taxes including payroll tax less efficient to varying degrees. For every dollar of tax raised from an efficient tax like the GST, there is less drag on economic growth compared to an inefficient tax like payroll tax or stamp duty. This is largely because efficient taxes are drawn from a much wider and less elastic base.

While some argue payroll tax would be more efficient without a threshold, this ignores the significant administrative cost and compliance burden which would be placed on very small businesses[2] and that payroll tax is only levied on one factor of production, labour, as opposed to capital. This penalises businesses which employ more people over those employing less.

Payroll tax also discriminates against local businesses with local manufacturers having to compete against importers to deliver the same products price competitively into local markets, with those importing businesses not liable for payroll tax by virtue of having few locally based employees.

Business SA ultimately wants payroll tax abolished to match leading economies such as New Zealand, where unemployment is 4.6%[3]. However, in the absence of national tax reform including the GST, South Australia must at least transition to offer the most competitive state-based payroll tax structure.

South Australia must at least transition to offer the most competitive state-based payroll tax structure.

South Australia should also lead on offering payroll tax relief for employers to hire STEM PhD graduates to bolster university and industry collaboration, as well as for apprentices and trainees to arrest our high rate of youth unemployment and to ensure required skills are in place for expanding industries such as defence and healthcare.

In Business SA's June Quarter 2017 Survey of Business Expectations, when asked whether the State Government should focus on payroll tax relief ahead of jobs grants programs such as the Jobs Accelerator Grant (JAG), 68.6% of businesses advised 'yes', 12.1% 'no' and a further 19.4% were 'unsure'. Consequently, Business SA recommends the State Government prioritise payroll tax relief ahead of jobs grant programs.

1 Tax White Paper (Discussion Paper) – noting Green Paper and White Paper yet to be released.
2 Federal Government, Tax White Paper Discussion Paper, page 144.
3 Stats NZ, Labour Market Statistics September 2017 Quarter, 1 November 2017.

03

Recommendation 1

Lift the payroll tax threshold from $600K to $1.5M, and reduce the rate from 4.95% to 4.5%, by 1 July 2020 to ensure South Australia has the most competitive payroll tax structure of any state.

All states and territories which have made improvements to their payroll tax system between 2008/9 and 2016/17 have experienced significant growth in collections, on average 50% faster than in South Australia.

Business SA welcomed the State Government's 2017/18 budget measure to permanently reduce the payroll tax rate to 2.5% for businesses with wages between $600,000 and $1 million, with a progressively increasing rate up to 4.95%, which applies to businesses with wage bills of $1.5 million and higher. If legislated, this would have been the first permanent change to South Australia's payroll tax system since 1 July 2009 when the rate was reduced from 5% to 4.95% and the threshold raised from $552,000 to $600,000. At that point in time, those changes were estimated to have saved businesses approximately $20 million a year.

Unfortunately, following the defeat of the State Bank Tax in November 2017, the State Government decided not to permanently implement its budgeted payroll tax relief to small business, committing only to enact administrative procedures to provide temporary relief for the 2017/18 financial year.

By 1 July 2018, it will be nine years since a permanent adjustment was made to South Australia's payroll tax threshold, which unfortunately is not subject to indexation.

Considering South Australia's CPI inflation rate has increased by approximately 20% over that period, [4] even an equivalent indexed rate today would be over $700,000.

Over the past eight years, every other state and territory has increased their payroll tax threshold (see table overleaf). The average increase in payroll tax thresholds across all states and territories since 2009 has been approximately $175,000, with the Australian Capital Territory leading the charge by increasing its threshold by $500,000.

While Business SA recognises increasing the payroll tax threshold to $1.5 million and reducing the rate to 4.5% will cost the existing budget approximately $213 million per annum[5], this does not accommodate the fact that such an economic policy decision will actually assist with growing tax revenues over time, including payroll tax. All states and territories which have made improvements to their payroll tax system between 2008/09 and 2016/17 have experienced significant growth in collections, on average 50% faster than in South Australia.

4 ABS, Consumer Price Index, December 2017.
5 Based on Revenue SA payroll tax collection data.

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Payroll tax rate and threshold
Comparisons across Australia

	Payroll Tax Rate			Payroll Tax Threshold		
	2009 Rate	Current Rate	Difference	2009 Threshold	Current Threshold	Difference
NSW*	5.75%	**5.45%**	0.30%	$638,000	**$750,000**	$112,000
VIC†	4.95%	**3.65% to 4.85%**	varies on location	$550,000	**$650,000**	$100,000
QLD‡	4.75%	**4.75%**	0.00%	$1,000,000	**$1,100,000**	$100,000
WA§	5.50%	**5.50%**	0.00%	$750,000	**$850,000**	$100,000
TAS¶	6.10%	**6.10%**	0.00%	$1,010,000	**$1,250,000**	$240,000
ACT	6.85%	**6.85%**	0.00%	$1,500,000	**$2,000,000**	$500,000
NT	5.90%	**5.50%**	0.40%	$1,250,000	**$1,500,000**	$250,000
SA**	**4.95%**	**2.5% to 4.95%**	**varies on size**	**$600,000**	**$600,000**	**$ –**

* New South Wales businesses with less than 50 employees are eligible for a payroll tax rebate of up to $6,000 for new full-time employees subject to certain conditions under the Jobs Action Plan. NSW also has a payroll tax rebate for specified apprentices and trainees determined by the NSW Department of Industry.

† Victoria's new threshold is being progressively implemented to be fully in place by July 2018. New rate of 3.65% only applies to regional businesses (i.e. those who pay 85% of their payroll to employees in Regional Victoria).

‡ Queensland offers a full payroll tax exemption on trainee and apprentice wages, and a temporary (expiring in July 2018) 50% rebate on an additional worker's payroll tax when a business employs an apprentice or trainee. Furthermore, the tax-free threshold for Queensland businesses, $1.1 million, gradually diminishes until a business reaches a $5.5 million payroll such that employers with taxable wages greater than $5.5 million are liable for payroll tax on their entire taxable wages.

§ Western Australia's tax-free threshold gradually phases out for employers or groups of employers with annual taxable wages in Australia between $850,000 and $7.5m. Employers with annual Australian taxable wages of $7.5m or more are liable for payroll tax on their entire taxable wages. Western Australia also recently introduced a 5-year temporary measure to increase the payroll tax rate to 6% for businesses with payrolls greater than $100 million, and 6.5% for payrolls greater than $1.5 billion. Wages paid to all apprentices and 'new' trainees only are exempt from payroll tax.

¶ Tasmania recently introduced a 3-year payroll tax rebate for new apprentices, trainees and youth employees (up to 25 years) applicable between 1 July 2017 and 30 June 2019.

**** South Australia's temporary 2.5% rate only applies to businesses with payrolls between $600,000 and $1 million. For businesses with payrolls between $1 million to $1.5 million, that rate progressively increases back up to 4.95%.**

05 Payroll tax collected
Data from various State Budget papers

	2008/9	2016/17	Growth	SA Payroll Tax collections if they grew with national average since 2009
NSW	$6,362,000,000	$8,225,000,000	29%	N/A
VIC	$4,023,000,000	$5,727,000,000	42%	N/A
QLD	$2,728,000,000	$3,667,000,000	34%	N/A
WA	$2,232,416,000	$3,255,594,000	46%	N/A
TAS	$266,000,000	$331,100,000	24%	N/A
ACT	$251,317,000	$445,357,000	77%	N/A
NT	$217,020,000	$284,239,000	31%	N/A
SA	**$913,000,000**	**$1,129,000,000**	**24%**	**$1,241,680,000**
National Total	$16,992,753,000	$23,064,290,000	36%	N/A

Even if South Australia experienced the national average growth of payroll tax since 2008/09, the State Government would have an additional $112 million in payroll tax revenue. While other factors across states and territories have also contributed to payroll tax revenues, there is a clear pattern of reforming payroll tax and actually growing collections.

We cannot continue to think about reducing the payroll tax threshold and rate as having to be revenue-neutral from day one. Business SA argues this is an economic policy choice which has been shown to improve the revenue base of all state and territory governments and South Australia must become more competitive to achieve the same growth. We will not grow our economy without making tough decisions to adjust to competitive tax settings.

Payroll tax remains the number one inhibitor of job creation for Business SA members, particularly those around the threshold, and reform can no longer be ignored. South Australia's payroll tax rate and threshold must be the most competitive of all states, particularly to help local businesses cope with the nation's highest utility costs. The next State Government must be willing to make bold steps to improve South Australia's competitiveness and it must start by listening to what is impacting the decision-making of business people.

Case Study 1

Tony Musolino started his company TRG Transport 21 years ago, operating mainly within South Australia.

"We should be decreasing the rate of payroll tax or removing it."

Tony employs 85 people and has transitioned from a small to medium business, and is concerned that the larger he grows, the more payroll tax he is forced to pay.

While Tony understands the state is built on small business and government services, he cannot understand why big business is being penalised when it should be encouraged in South Australia.

"Why would you be discriminated against because you've invested more?" Tony says.

"We seem to have this thing in our head that big business should pay. We should be decreasing the rate of payroll tax or removing it."

With a state once built on manufacturing and Holden and Mitsubishi now gone, Tony says encouraging large international businesses to set up Australian headquarters or warehouses in Adelaide—where transport and real estate costs are lower—would help create jobs and boost the economy, but payroll tax breaks are needed.

Case Study 2

As managing director of Accru Harris Orchard, an accountancy firm founded more than 50 years ago, James Orchard and his staff offer taxation and other financial advice to up to 500 small business clients.

"Payroll tax is the most illogical of all taxes and a disincentive to employing more people."

One of the biggest issues his own firm has to deal with, along with other businesses he deals with, is payroll tax and its impact on employment.

"Payroll tax is the most illogical of all taxes," James says. "Business understands the need for tax in a cohesive and democratic society, but to have a tax that's connected to the employment of other people is just nonsensical."

James says payroll tax is a disincentive to employing more people. He does not want to see rates lowered or thresholds increased—he wants to see it abolished.

"The growth rates in South Australia are lower than the other states and we should be looking at the highly innovative places overseas, where they have done radical things to improve business."

"Payroll tax is just stupid. It doesn't matter whether it's Jay Weatherill or Steven Marshall, it's got to go. If we really want to give business a leg-up, it's got to go."

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Case Study 3

David Snoad runs Pinz, a second-generation family business which began as an Adelaide based manufacturer of leather clothing in the 1980s.

"Payroll tax is not a broad-based tax. It penalises companies that have high staff numbers to turnover ratios."

When China and India starting exporting cheap garments, they needed to diversify. Pinz morphed into a manufacturer of spa and jacuzzi covers, and later diversified again into outdoor blinds and awnings. David employs 55 staff over winter, which grows to about 70 when seasonal work increases at the start of summer.

David feels payroll tax is not levied on a level playing field. His business competes with overseas suppliers to retail giants such as Bunnings, and those suppliers pay no payroll tax and can therefore sell their products much cheaper. He says the whole system is "anti-competitive".

"It's not a broad-based tax, it penalises companies that have high staff numbers to turnover ratios," David says.

"It's a massive additional cost when you compare it to importers that have very few staff."

David says the threshold should be lifted immediately to make South Australia a more competitive investment destination for manufacturing. He also says the payroll tax penalises companies which grow rapidly with his increase alone over the past two years equalling two staff's wages.

Case Study 4

Phil Mildren owns and operates SA Solid Surface Fabricators, a joinery business which commenced operations in 1974 and expanded into fabricating solid surface benchtops in 1980.

"Payroll tax should be abolished because it hurts all businesses and influences whether we employ more people."

Phil's business is on the borderline of having to pay payroll tax every year—some years he does and some years he doesn't have to—but it has had an impact on whether or not he pushes expansion plans.

"I think it should be abolished because it hurts all businesses, and the smaller companies where the owners are on the payroll, so to speak," Phil says.

"Payroll tax influences whether we employ more people, your expenses go up and the only thing that doesn't go up are your fixed payments. But you've got to do everything you can to know where these payments are, rather than having scary electricity bills appearing."

Phil says he's a swinging voter, and if changes were made to payroll tax, or it was abolished as he wants to see, it could change his vote.

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Case Study 5

Founded in the early 1970s, Bowhill Engineering is a specialist heavy and complex steel fabrication supplier based in the Murraylands and employing over 30 full time staff.

"It's a really big thing to go over that threshold of $600K, and you question taking on more staff in case you go over."

Chief Financial Officer Jodie Hawkes, whose father-in-law started the company, says the tax is a direct disincentive to employment and should be abolished. If not abolished, she would like to see thresholds lifted and rates applied on a sliding scale otherwise growing companies are being disadvantaged.

Jodie says the amount the regional company contributes in employment tax covers at least one extra wage.

"When you go up to that threshold of $600,000 it's a really big thing to go over that, and you question taking on more staff in case you go over," Jodie says. "We're always trying to take on new staff and apprentices but we end up paying more taxes."

Case Study 6

Automotive repair business owner Lex van Blyenburgh supports any initiatives to lower employment costs for businesses, and has in the past watched as thousands of dollars have gone to government coffers based simply on employee salaries.

"Payroll tax is a dead weight around the neck of any business. It defies logic in that the more business you do and the more people you employ, the more you have to pay."

Lex, whose business Jaustech Automotive has employed apprentices and trainees in the past, said it was difficult to employ a young person working towards their qualification, because their role was to watch and learn, and not contribute on the floor.

"Apprentices for us in the past have made up about 25 per cent of our floor, and it's very hard to absorb that cost," Lex said.

He supports any moves which would reduce or remove payroll tax paid on apprenticeship or trainee salaries, saying it would incentivise businesses to employ more young people if they didn't have to pay such an "unproductive tax".

"Payroll tax is a dead weight around the neck of any business, it defies logic in that the more business you do and the more people you employ, the more you have to pay," he said.

"If I needed to grow my workforce and I was given some relief, it's money I could put into productive ventures. I'd be happy to invest $30,000 a year into an apprentice because then when they're fully qualified they start working well for your company."

Recommendation 2

In the process of reducing the payroll tax rate to 4.5% by 1 July 2020, ensure the reduced rate is only available to companies which either move to, or retain their headquarters in, South Australia.

State Government must value businesses that start, expand and remain based in Adelaide, as opposed to just those incentivised to move here.

Business SA's origins date back to 1839 and we have several members that have been with us for more than 100 years. The optimum way to attract businesses to South Australia is to focus on the actual costs and ease of doing business, including the availability of excellent infrastructure.

There have been numerous examples of the State Government paying high profile interstate businesses millions of dollars to relocate their headquarters to Adelaide. While these businesses may remain in Adelaide, there have been many examples of those which have not, including JP Morgan. What message does it send to the thousands of South Australian businesses which have built the foundation upon which the South Australian economy rests today? The State Government must value businesses that start, expand and remain based in Adelaide as opposed to just those incentivised to move here.

The definition of a headquartered business can be legally defined, and our broader proposal to reduce the payroll tax rate should be based on the requirement for suitably large businesses to remain headquartered in South Australia. This proposal will not only attract new companies to headquarter in South Australia with a lower payroll tax rate than other states and territories but will ensure existing companies which retain their headquarters here are advantaged over those which either move interstate or overseas.

The State Government should more formally recognise the benefits long-established South Australian businesses provide. If we do not appreciate and nurture the businesses which make long-term commitments to operate here, we will only have to deal with a more uncertain future as they increasingly look to move interstate or offshore.

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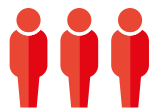
Recommendation 3

Introduce a payroll tax incentive for Science, Technology, Engineering & Maths (STEM) PhD graduates to increase collaboration between universities and business, with an exemption equivalent to 200% of wages.

This would be an Australian first incentive and send a clear signal that South Australia aims to be the leading state for university business collaboration.

Business SA has long been calling for a tax system which better incentivises collaborations between universities and business, beyond the current research and development (R&D) tax incentive. We also acknowledge the Australian Technology Network of Universities 2016 report 'Enhancing the value of PhDs to Australian Industry' specifically recommended tax incentives to encourage businesses to engage with PhDs.

It is well known that Australia performs poorly amongst Organisation for Economic Co-operation and Development (OECD) peers for collaborations between the university sector and industry, with the most recent data placing Australia last out of 33 countries, behind Russia, Brazil and Mexico.[6] Furthermore, Australia has only 3 researchers per 1,000 workers, compared to Finland having 14 and even Canada, a country with more comparable geography, population and GDP, having 7.[7]



Australia has only 3 researchers per 1,000 workers

Canada has 7 researchers per 1,000 workers

Finland has 14 researchers per 1,000 workers

6 OECD, based on Eurostat (CIS-2010) and national data sources, June 2013.
7 Office of the Chief Scientist, Speech to AMSI Accelerate Australia Conference, 2013.

While the Research and Development (R&D) tax incentive is well placed to incentivise businesses to undertake more formal research and development projects, it is not as effective at generally improving the connectivity between universities and SMEs. Many SMEs are not even aware of the technical capability and expertise within universities and even if they did, would not know how to engage with a university. Steps need to be taken to break down those barriers to help our economy realise the benefits from collaborations, particularly to improve industrial/manufacturing processes, and to help develop new products and services.

As a practical start to appeal to the broadest number of suitable businesses, the State Government should focus on increasing the number of STEM PhD graduates employed by SMEs. In recent OECD data, Australia's percentage of PhDs employed in Manufacturing, Agriculture, Mining and other Industry sectors was 33% below the OECD average.[8]

PhD graduates are trained to problem solve and think critically; and embedding more PhDs in industry is the most direct way to impart an understanding of the expertise and technology within universities, particularly for SMEs. Subsequently, those PhDs will be better able to help SMEs form partnerships with universities to assist them with potential R&D projects, or even to simply access advanced technologies or expertise to help with reviewing existing processes with the latest technological insights.

While Business SA recognises that the university sector itself needs to be better incentivised to work with industry, improving understanding from both sides about one another's capabilities and drivers is the first bridge to cross. Having more PhDs employed in SMEs, who by the nature of their qualification have worked at an equivalent staff level within universities, will enable SMEs access to people who are strongly connected within the university sector and whose understanding of available technology and resources is high.

Business SA recommends the State Government implement a 200% payroll tax exemption for all SMEs which employ a STEM PhD graduate, with eligibility based on having company turnover of $100 million or less. This would be an Australian first incentive and send a clear signal that South Australia aims to be the leading state for university business collaboration. To provide an adequate enough incentive for employers who might be concerned about the cost of employing a STEM PhD graduate, the payroll tax exemption should apply to the first five years of their employment.

Since 2012, an average of 330 STEM PhD students have commenced each year at South Australian universities while annual completions have increased from 125 to 181 over the same period,[9] representing a 45% increase. Even if the payroll tax exemption helped encourage an additional 50 STEM PhDs per annum into South Australian industry, particularly manufacturing and agribusiness, this would only cost approximately $400,000 in year one and $2 million per annum by year five. South Australian universities could also use this policy as a marketing tool to attract new STEM PhD students. For South Australia more broadly, the policy could help limit the brain drain of our most educated young people to the eastern states.

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Although the State Government could consider grants to help employers with hiring STEM PhDs, SME employers' hiring decisions are most impacted by payroll tax and subsequently, a signal through payroll tax will resonate much more broadly than any grant program and its associated compliance. Furthermore, while there may be a potential collaboration premium emanating from the Federal Government's R&D tax Incentive Review to incentivise employers to hire STEM PhDs, this will not necessarily be suitable for the broader cohort of SMEs that are not engaged with formal R&D projects. Any collaboration premium through the R&D tax incentive will also constrain SMEs to hiring STEM PhDs for specific projects, rather than investing in employing those graduates for the longer-term growth of their businesses.

8 OECD calculations based on OECD/UNESCO Institute for Statistics/Eurostat data collection on Careers of Doctorate Holders 2014; EU Labour Force Survey (micro-data) and US Current Population Survey, July 2015.

9 Federal Government Department of Education and Training, customised data set, December 2017.

Recommendation 4

Re-introduce the payroll tax exemption for wages paid to apprentices and trainees.

Prior to the 2010 election, former Premier Mike Rann announced a four-year relief plan promising to abolish payroll tax for apprentices and trainees. This tax exemption was subsequently abolished in the 2012/13 State Budget with the resultant $30 million per annum savings redirected to better target support for training in areas of critical skills under the now defunct Skills for All program.

There were several funding changes at both a State and Federal Government level across 2012-14, concurrent with material wage increases imposed by the Fair Work Commission, which impacted training and apprentice commencements. However, subsequent to the associated falls from these policy decisions, trade apprenticeship commencements in South Australia have further declined 16.7% from 2015-2017 and trainee commencements by 13.9% over the same period.[10]

South Australia's youth unemployment rate as at December 2017 stood at 12.8%, more than twice the general unemployment rate of 5.9%. While there have been some positive signs for apprenticeship commencements, including machinery operators and drivers up 116% and automotive and engineering trades workers up 14.7% over the past 12 months,[11] there is a fundamental need to better incentivise employers to commit to hiring apprentices and trainees.

The State Government's Strategic Plan set a target of increasing apprentice completions in trade occupations by 20% by 2020 based on a December 2009 baseline.

However, the reported level of trade apprenticeship completions has remained flat with 2,670 for the year ending December 2009 compared with 2,665 for the year ending June 2017.[12]

Young people in particular are bearing the brunt of South Australia's weak economic performance, and the State Government must use its primary policy lever of payroll tax relief to redress this situation. Although the rate of youth unemployment will vary across regions, payroll tax relief to encourage employers to take on apprentices and trainees should not be region specific given the higher tendency of young people to move for employment.

Young people in particular are bearing the brunt of South Australia's weak economic performance, and the State Government must use its primary policy lever of payroll tax relief to redress this situation.

Business SA acknowledges that New South Wales, Western Australia, Queensland, Tasmania and the Australian Capital Territory all provide varying degrees of payroll tax rebates/exemptions on apprentice and trainee wages. However, to avoid red-tape on South Australian employers, an outright exemption structure is the preferred option, following on from the example of the 2017/18 State Budget measure (still to be legislated) of the small business payroll tax rebate being converted into a permanent cut.

There has long been a rebate on 'Return to Work' premiums for apprentices and it follows suit that the payroll tax exemption should also be restored. If the State Government is willing to acknowledge through formal policy that employers should not have pay 'Return to Work' premiums for apprentices, there is no reason why payroll tax should be payable on apprentice wages.

10 National Centre for Vocational Education Research (NCVER), Apprentices and trainees 2017: June Quarter, Australia.
11 NCVER, Apprentices and trainees 2017: June Quarter, Australia.
12 NCVER, Apprentices and trainees 2017: June Quarter, Australia.