

APPENDIX A: COSTING REPORT — TAX DEDUCTION FOR ENTERTAINING IN RESTAURANTS

Name of policy costed:	Tax deduction for entertaining in restaurants
Person making the request:	Andrew Wilkie MP
Date received from Prime Minister's office:	2 March 2011
Summary of policy:	To increase restaurant business revenues by making entertaining in restaurants a tax deduction with the effect that, to the extent these benefits are provided to employees, they would be exempt from fringe benefits tax.
Additional information requested (including date):	NA
Additional information received (including date):	NA

FINANCIAL IMPLICATIONS – TAX DEDUCTION FOR ENTERTAINING IN RESTAURANTS

(Outturn prices)(a)

Impact on	2010-11	2011-12	2012-13	2013-14	2014-15
Underlying Cash Balance (\$m)	0	-270	-240	-240	-250
Fiscal Balance (\$m)	0	-230	-240	-240	-250

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in revenue or a decrease in expenses or net capital investment in cash terms.

Proposal:

- 1% of all business turnover spent on genuine hospitality expenditure by a business is fully deductible (up to a maximum cap of \$25,000 per annum).
- 1% of all business turnover spent on genuine hospitality expenditure by a business is FBT exempt (up to a maximum cap of \$25,000 per annum).
- All hospitality expenditure above 1% of turnover or \$25,000 per annum attracts FBT and is not deductible.
- The proposal makes the claim that these changes would result in "a small budgetary cost", that the decrease in FBT and company tax would be partially offset by increases in GST, PAYG and hospitality industry company tax.

Costing assumptions:

- Fringe Benefits tax rate: 46.5%
- Company tax rate: 30%
- Fund tax rate: 15%
- Average marginal tax rate: 31.5%
- Restaurant profitability:
 - 4% for existing dining
 - 6% for new dining as a result of employer's utilisation of this proposal (Restaurants are assumed to have a higher profit margin from the additional activity generated by this proposal due to their fixed costs of operation being spread over the increased customer base.)
- Effective GST rate on restaurant dining: 1.5%
- Growth rate applied to historical calculations of FBT on meal entertainment: 5% p.a.
 - While the proposal has a cap of \$25,000 per employer, growth in revenue for businesses below the cap would allow growth in the value of overall claims as would growth in the number of businesses.
 - Base number of employers providing meal entertainment is approximately 16,000 (Taxation Statistics 2008-09)
- Behavioural assumptions:
 - Number of new employers providing meal entertainment in restaurants: 20,000
 - : This effectively doubles the number of businesses conducting meal entertainment in restaurants. This assumption leads to a reduction in personal income tax collections as new users of the proposal exchange salary for meal cards or restaurant vouchers.
 - : The percentage of this increase in meal entertainment in restaurants that is new restaurant spending is assumed to be 50%. The remaining 50% is assumed to be restaurant spending that would have occurred in any case without the change in tax treatment (e.g. as private expenditure).
 - Number of employers currently providing in-house dining who switch to restaurant dining: 20,000 (The effect of this assumption is marginal as activity switches from in-house activity or caterers to the hospitality industry).

Qualifications:

A lack of data and insufficient policy specification means that this measure is essentially unquantifiable. The costing provided is heavily assumption driven and therefore this costing has low reliability. Based on what we do know and the use of what we believe are reasonable assumptions (listed above) this proposal is estimated to result in a cost to revenue of \$1 billion over the forward estimates period.

While different assumptions would result in somewhat different costings, we anticipate that in all cases the cost could still be expected to be significant. A simplified perspective on this proposal would be to look at a single representative employer who uses this new regime to dine with clients in restaurants. If under this new proposal the employer decides to spend \$25,000 on restaurant dining for business purposes they can claim this expense as a tax deduction. This would reduce company tax by \$7500. However, restaurant turnover has increased by \$25,000. Of this amount \$2273 is GST (which will be distributed to the states). The restaurant is left with \$22,727 and assuming a rate of profit of 6%, would result in an increase to taxable income of \$1364. The tax due on this amount would be \$409. Therefore, total tax revenues would be 2273+409-7500 which equals a loss to revenue of \$4818. Even a profit rate of restaurants of 50% would lead to a loss of revenue of \$1800. In short, the greater the take up rate of this proposal by employers, the greater the cost to revenue.

Treasury and the ATO were unable to replicate the costings supplied by industry with this proposal using data driven assumptions and budget costing rules. In particular, budget costing rules do not in general include second round impacts. Accordingly, the increase in company tax from the possible increase in profitability of restaurant suppliers has not been included. However, this effect is likely to be negligible and thus we could not expect the above costings to be significantly different. For instance, in respect of the impact of the proposal on the restaurant food suppliers, people who eat in restaurants as a result of this proposal would otherwise still consume food bought from food suppliers, but would consume that food under different circumstances.

The impact on net income on employee wages and salaries is expected to be negligible.

Where relevant, include separate identification of revenue and expense components:

Not applicable.

Where relevant, explain the costing methodology used such as - costing techniques; policy parameters; statistical data used:

The revenue impact of exempting meal entertainment from FBT up to the proposal amounts was estimated for reported meal entertainment activity (ATO data) and this was used as a base for the costing. In addition, companies would no longer be able to claim a deduction for the FBT expense. (This has the effect of reducing the cost of the proposal.) Added to this were calculations around new spending in restaurants and the impact on Commonwealth and GST revenues.

Where relevant, insert the behavioural assumptions used:

See assumptions section above.