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18 July 2018

Board of Taxation Secretariat
The Treasury – Melbourne Office
Level 6, 120 Collins Street
Melbourne VIC 3121

By email: taxboard@treasury.gov.au

Dear Sir/ Madam

Subject: Review of Small Business Tax Concessions

CPA Australia represents the diverse interests of more than 163,000 members in 125 countries. We make this submission on behalf of our members and in the broader public interest.

Further to our discussions with the Board of Taxation small business tax concessions working party on 25 June 2018, we now provide the following submission. It focusses on the proposal of a number of options to encourage new businesses to start and grow in Australia.

Although not definitive in its conclusions, CPA Australia's submission includes the proposal that a new business entity may provide another incentive for more businesses to start and stay in Australia, see **Attachment A.**

The proposals and subsequent discussion in **Attachment A** touch on the Review's consultation questions numbers 3, 5, 8 and 12.

At the meeting referred to above we also discussed CPA Australia's annual survey of small businesses based in the Asia Pacific. The 2017 survey was CPA Australia's ninth and included responses from nearly 3000 businesses with less than 20 employees. Excerpts relevant to the inquiry in the context of Australian business can be found in **Attachment B.**

If you require further information on the views expressed in this submission, please contact Gavan Ord, Manager – Business & Investment Policy, on +61 3 9606 9695 or at gavan.ord@cpaaustralia.com.au.

Yours sincerely

Paul Drum

Head of Policy

A new entity for small business

CPA Australia has been an advocate of a simplified entity for small business particularly new start-up businesses for many years. We note that others have also considered the merits of a new simplified entity for SMEs.

For example the Australian government's Re:think tax paper discussed the virtues of a US 'S-Corporation' type entity for SMEs.[1] However like much of the Re:think paper nothing has evolved from that process.

Rightly or wrongly the Australian tax system has evolved over the last century around taxing different types of business structures, forms and entities – rather than taxing, for example, all business income the same regardless of the entity in which it is derived. The system is complex, with choice of structure and entities playing a significant role in contributing to this complexity.

Arguably for many small businesses complex multiple entity structures are not required for tax minimisation purposes at all when one considers the point at which the 30 per cent individual rate cuts out – which is now at $90,000 per person. For a husband/ wife type family business this effectively enables them the earn $180,000 p.a. before moving to a tax rate higher than the prevailing standard company tax rate (but more than the new small business company tax rate of 27.5 per cent.).

Opportunities for tax minimisation with smaller family sizes and with tight rules about income for minors have effectively brought an end to this type of tax planning many years ago.

It is too late to wind back the layers of complexity regarding business structures in Australia. However, CPA Australia is of the view that to encourage new businesses to start up and grow – and the help them avoid the costs that accompany complex business structuring - especially in their formative years there are options that should be explored.

There are a number of ways the above objective of encouraging new small business and helping them to grow could be achieved. For example, CPA Australia has considered the idea that a new type of entity could be developed and introduced into the small business arena that would have features like that of a so-called US S-Corp, such as limited liability, income streaming, and flow-through of income to beneficiaries. However – and importantly - it would also need the additional features of being able to retain income in the entity that would be subject to income tax at non-punitive rate. It would also preserve the current small business capital gains tax concessions. amongst other things.

Our organisation's thinking behind this is that at present a typical and relatively vanilla or ordinary commercial family business structure often requires establishing multiple entities and conduits – for example a corporate trustee, a discretionary trust, and with the trust beneficiaries including a corporate beneficiary.

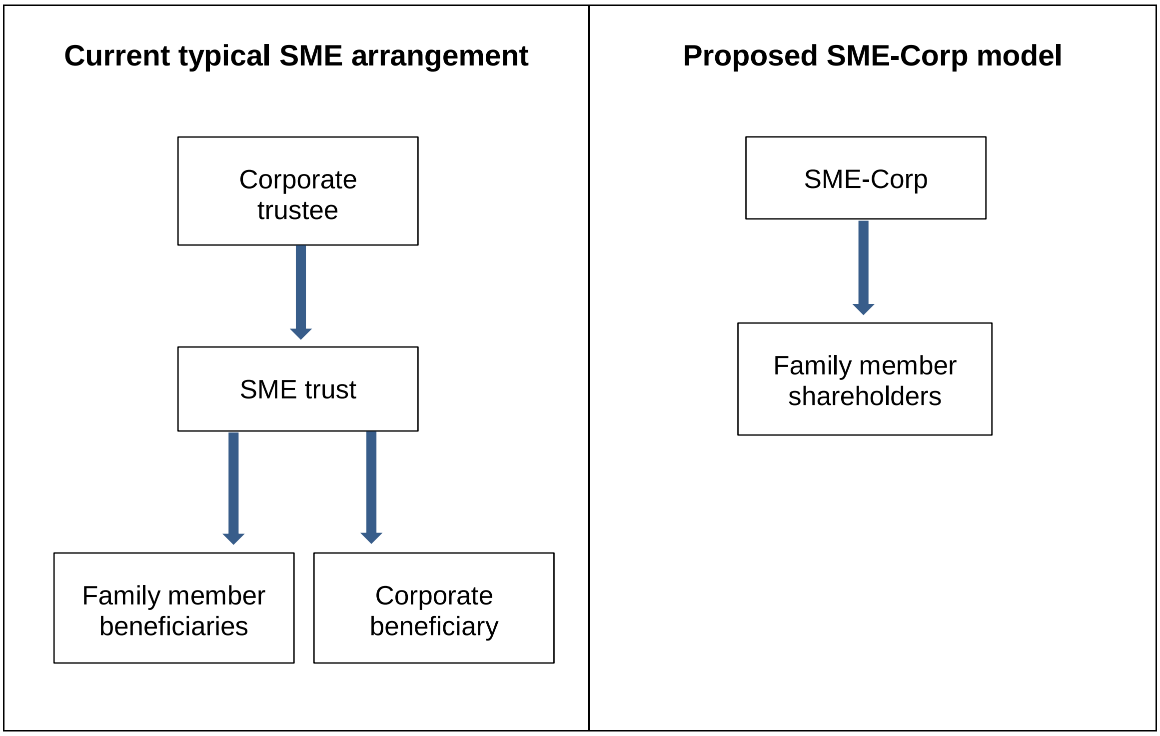
This is done for many reasons - such as ensuring the business has the protection afforded by limited liability, and to enable the business to more readily expand and grow, and to give structural flexibility for 'future eventualities'. Further, and in the context of the BoT's Review remit, it is also done to ensure that the possible future access to a suite of pre-existing SME focussed income tax concessions - particularly the CGT small business concessions - will not be ultimately be denied to them. This complexity can act as a disincentive to people establishing a business, or growing that business.

The introduction of a new entity – for the purposes of this submission we will call it a 'SME-Corp' - that has the features of limited liability, allows income streaming like a discretionary trust, allows income retention and is taxed at an appropriate non-punitive rate – for example the prevailing small business

[1] See http://bettertax.gov.au/publications/discussion-paper/ at pp109-110. See also the relevant full extract reproduced in Attachment B of this submission.

company tax rate – would potentially eliminate the need for three entities, reducing the entity structures required in this example from three to one – see Figure 1 following:

Figure 1



Discussion

However, it is important to understand that there is no silver bullet here. Introducing another entity for new businesses from which to choose when they are establishing themselves adds additional complexity to already complex system. Further, there is no guarantee that new businesses will avail themselves to such a new entity either. The uptake by new businesses of an additional choice of entity will depend in the main on the design features of such an entity.

Different types of business have different needs also, and this influences their decision-making. For example, if we distinguish between a traditional family business as a compared to a modern ‘start-up’ business the goals and objectives are different - as are their needs. Consider the following scenarios:

The ‘traditional’ family business

The traditional family business may have more limited aspirations of growth and therefore less demand for say capital raising/ outside capital. In this case a business structure that is based around a discretionary trust will still probably be the choice of entity. The growth of these businesses effectively depends on the reinvestment of retained earnings.

In this scenario, their prospects of growth and success would certainly be enhanced if non-fixed trusts deriving business income were able to retain income at the corporate rate. This would also provide some simplification by removing the need for a separate corporate beneficiary, as well as overcome the complexity of the Division 7A private company loan rules in these cases at least.

Further, CPA Australia submits that legislatively such an outcome may also be easier to achieve than for example introducing a new entity for small business.

The modern 'start-up' business

The modern start-up business however has different needs. It is essentially an incubator seeking to attract capital and grow substantially. As such a corporate structure where the shares are owned by discretionary trusts may be the better outcome for them.

In both the scenarios described above, we note the structuring outcomes can be achieved via currently available entities and structures – with the exception of income retention referred to in the traditional family business scenario.

Key issues regarding a new entity for small business

As mentioned earlier, introducing a new entity (a SME-Corp) for small businesses and their desire to use a new simplified structure will depend entirely on the design features.

We also appreciate there are competing interests to be considered – the main ones being encouraging businesses to commence and grow while at the same time being cognisant of the imperative to protect government tax revenues. Notwithstanding this fact there are a number of key issues that need to be considered from a design perspective.

The following is a summary of what CPA Australia believes to be the main features and issues for the BoT's consideration.

1. SME-Corp offers limited liability protection.
2. SME-Corp enables income streaming.
3. SME-Corp enables flow-through of income to beneficiaries.
4. Is able to retain income in the entity taxed at the prevailing small business corporate tax rate.
5. SME-Corp members/ group members – for integrity purposes this may need to be limited to natural persons, and perhaps even limited in the number of natural persons.
6. Rollover relief – rollover relief would be required like how natural persons can roll over up to a company structure without triggering CGT as is currently the case.
7. The SME-Corp would only be available to residents.
8. The SME Corp rules would only apply to active businesses.
9. The SME-Corp would not be available as an investment vehicle primarily deriving passive income.
10. Where income was retained by the SME-Corp at taxed at the prevailing relevant tax rate future dividends would be subject to the dividend imputation regime.
11. CGT concessions – flow through to individuals
12. To avoid confusion the S-Corp may only apply to new businesses that elect to go down this path from the date the law commences.
13. It is envisaged that the normal corps law as applies to other companies would apply. However, it is unclear whether there are corporate law issues that need to be considered in the context of what is being proposed in this submission.

Alternative options

CPA Australia also notes that it has also considered other models relevant to this review in the past, for example in its submission to the Consultation Paper issued in November 2011 entitled 'Modernising the taxation of trust income – options for reform'[2]

[2] https://static.treasury.gov.au/uploads/sites/1/2017/06/CPA_Australia_submission-1.pdf

At that time CPA Australia submitted, inter alia, that its preferred model of taxing trusts was to have three separate models for taxing trust income. The three models consist of:

- an attribution model for fixed trusts
- a flow through model for non-fixed trusts (which would be the default position), and
- an accumulation model for non-fixed trusts (which would be an elective model).

The essence of CPA Australia's submission to that prior review was as follows:

- Fixed trusts would be taxed like managed investment trusts (MITs).
- Non-fixed trusts used for passive investment would be taxed as trusts
- Non-fixed trusts that carry on a business would be taxed as a company.

We encourage the working group to consider these options also.

Board of Taxation review of small business concessions

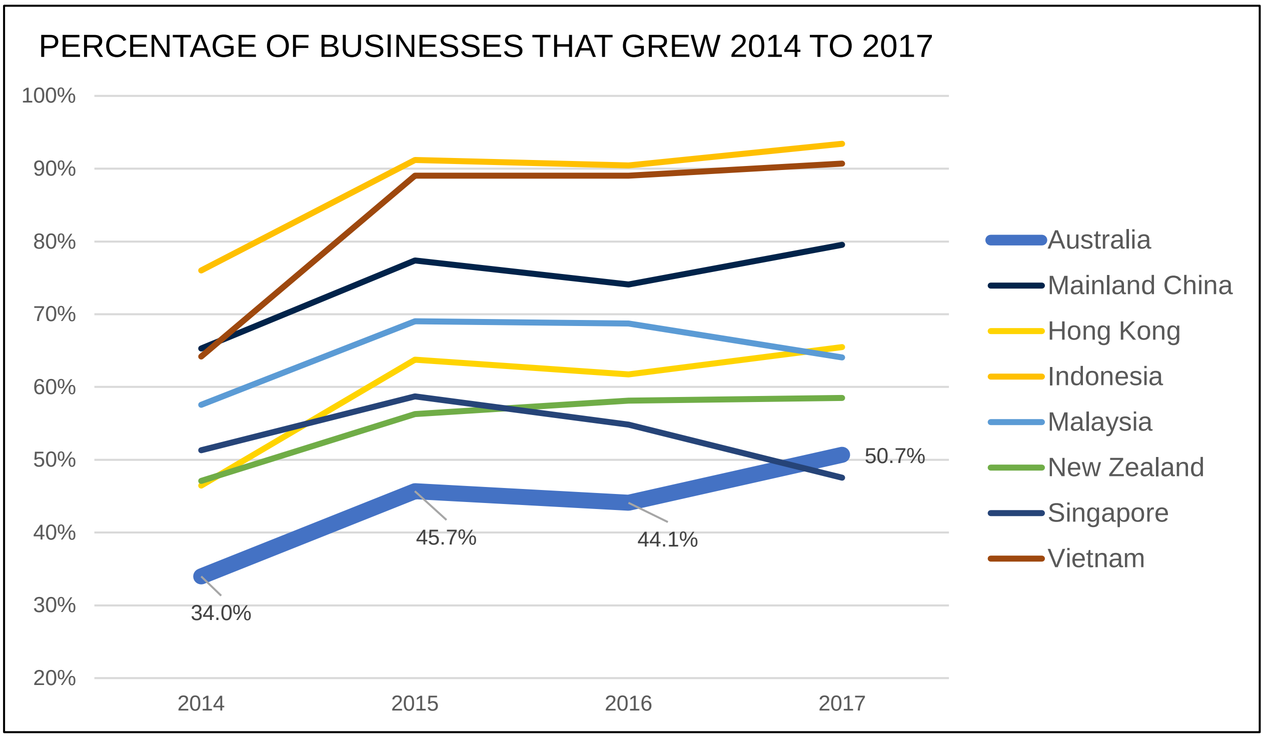
CPA Australia runs an annual survey of small businesses based in the Asia Pacific. The 2017 survey was our ninth and included responses from nearly 3000 businesses with less than 20 employees. The survey was run in eight key markets of the Asia-Pacific including Australia and China. The survey provides longitudinal data on a number of factors including:

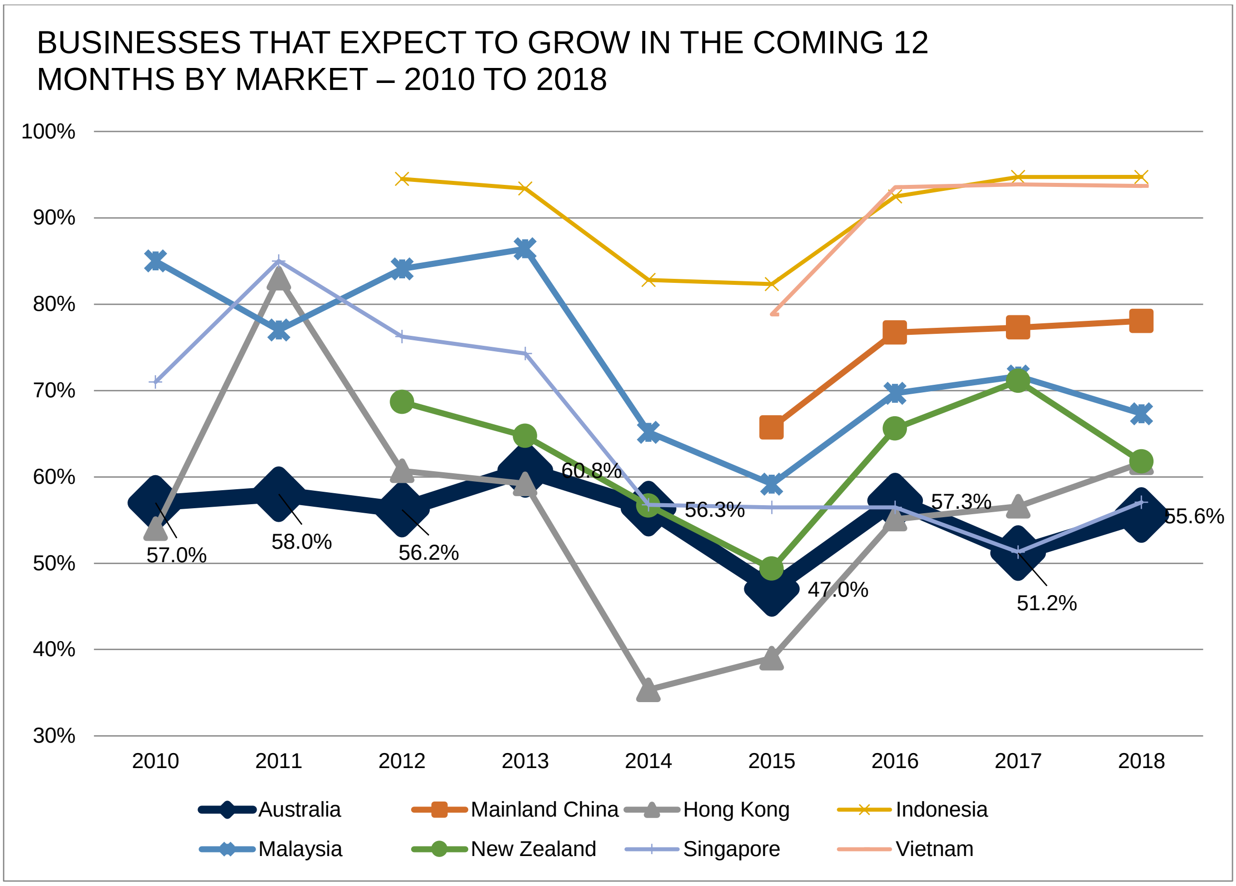
- drivers of small business growth
- small business adoption of technology
- small business access to finance
- small business confidence and conditions

In our most recent survey, we found that small businesses were most likely to report growing strongly where they:

- invest in technology, including new digital payment technology
- focus on innovation through new products, processes or services
- seek to grow their revenue from exports
- use social media for business purposes
- make online sales an important part of their business
- focus on improving business strategy and management

The survey results showed that Australian small businesses were far less likely to have grown in 2017 and far less likely to expect to grow in 2018 than small businesses from Asia.





When looking at the activities that growing small businesses are more likely to undertake, we see some significant differences between small businesses in Australia and Asia:

Comparison of activities associated with growth - survey average for Asia, Australia and New Zealand

	Australia	New Zealand	Asia average
Expect to introduce a product, service or process new to their market or the world	7.4%	9.2%	29.1%
Expect revenue from overseas markets to grow strongly	6.7%	8.2%	24.6%
Did **NOT** use social media for business purposes	42.5%	40.8%	9.5%
Received 11 per cent or more of their sales through new payment technologies such as AliPay, ApplePay and WeChat Pay	33.3%	33.0%	58.4%
Earned 11 per cent or more of their revenue from online sales	30.3%	26.8%	63.8%
Found their investment in technology in 2017 was already profitable	26.6%	26.8%	63.3%
Improving business strategy was one of the most positive influences on their business	14.1%	12.7%	28.1%

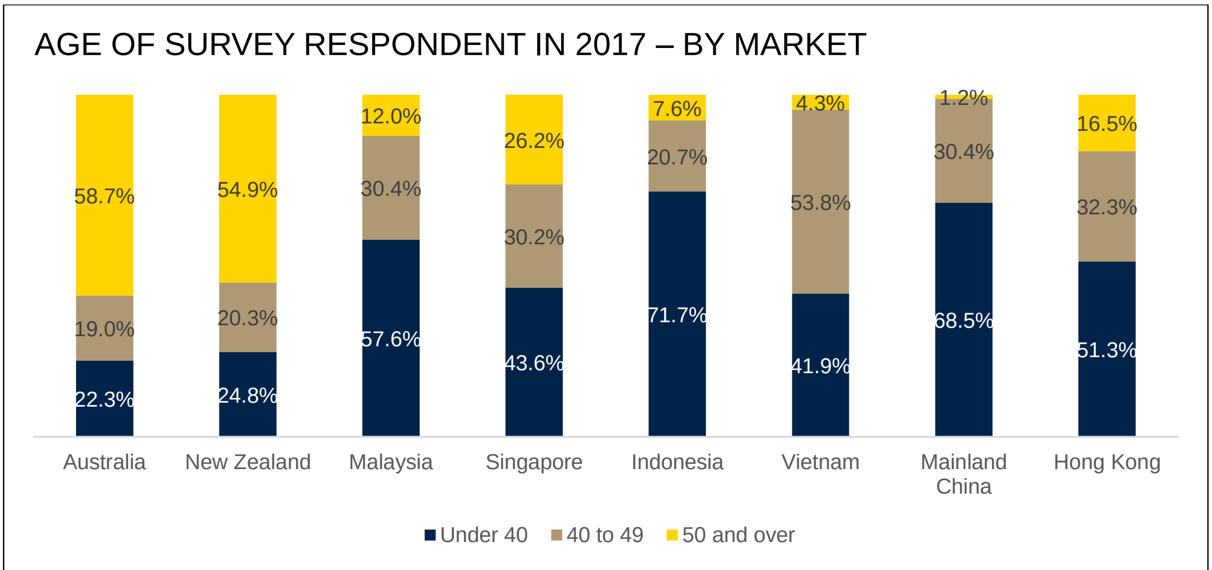
Improving business management was one of the most positive influences on their business	11.7%	12.7%	27.7%

Other key differences between the survey average for Asia, Australia and New Zealand

	Australia	New Zealand	Asia average
Businesses that expect local economy to grow in 2018	42.3%	39.9%	69.7%
Increased employee numbers in 2017	13.7%	14.1%	42.2%
Expect to increase employee numbers in 2018	18.8%	17.6%	49.4%

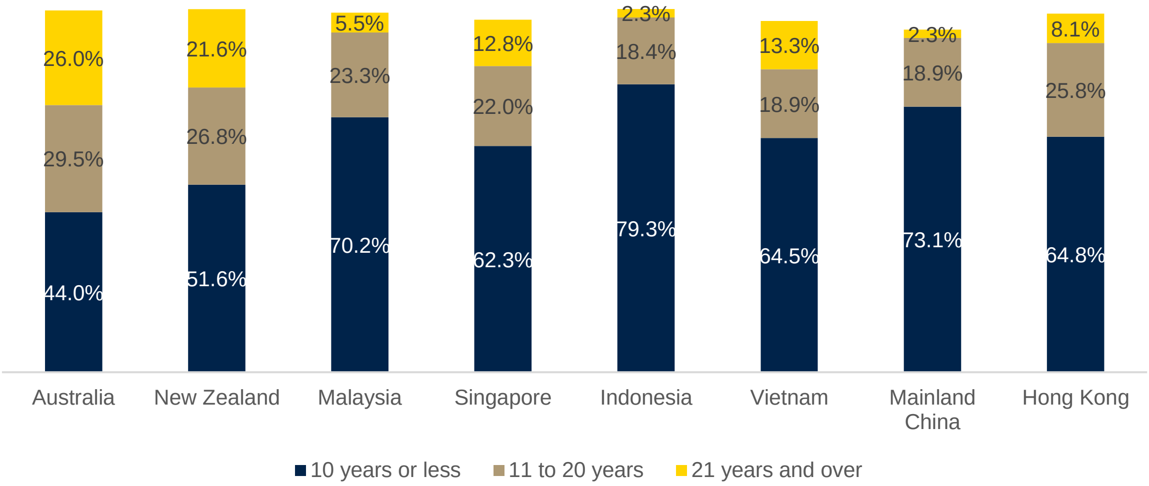
The demographics of Australian small businesses are significantly different from Asia. The survey data shows:

- Australian small business owners are significantly more likely to be older than small business owners from Asia. The survey data also shows that younger business owners are more likely to report that their business is growing, adding new staff, innovating, exporting, investing in technology and using digital technologies such as social media to interact and transact with customers.



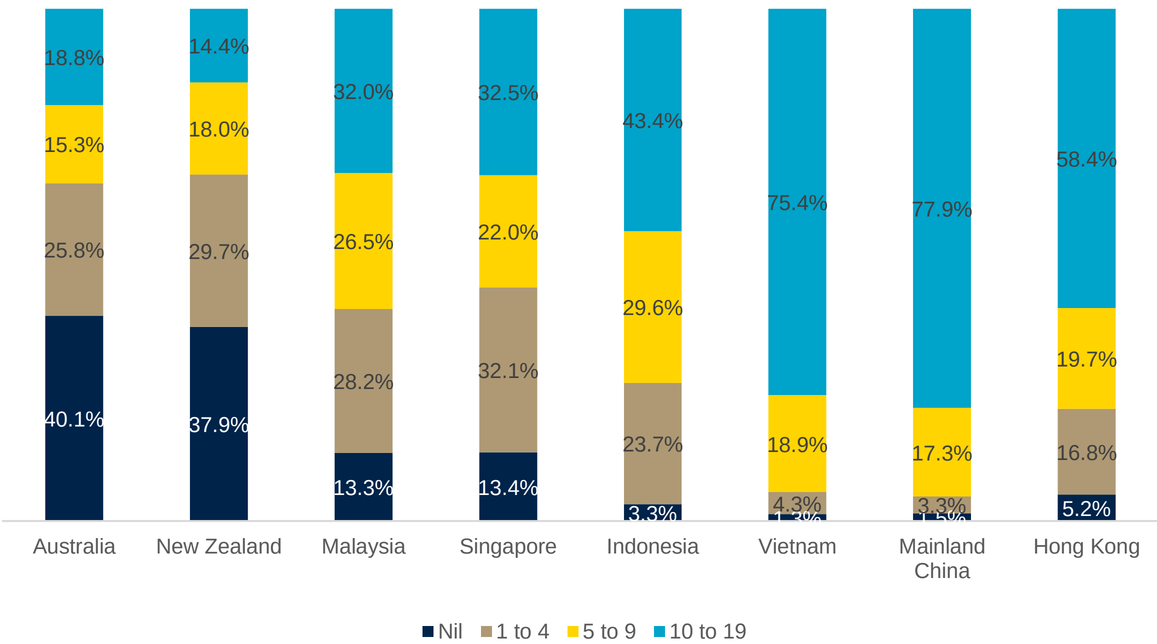
- Australian small businesses are more likely to have been established for longer periods than small businesses from Asia. Survey data shows that small businesses that have been established for less than ten years are much more likely to be growing, adding new staff, innovating and using digital technologies such as social media to interact and transact with customers.

HOW MANY YEARS THE BUSINESS HAS BEEN ESTABLISHED IN 2017– BY MARKET



- Australian small businesses are significantly more likely to be sole traders with no staff or less than five staff than businesses from Asia. Again, the survey data shows that small businesses with five or more staff are much more likely to be growing, adding staff, innovating, exporting, investing in technology and using digital technologies such as social media to interact and transact with customers.

SIZE OF THE SMALL BUSINESS BY EMPLOYEE NUMBER IN 2017 – BY MARKET



The survey results show that attracting younger people to start their own business can have positive impacts on economic growth, jobs and innovation.

Key differences in survey results between respondents aged under 40 and those aged 50 and over (all markets combined)

	Percentage of respondents under 40 (n=1419)	**Percentage of respondents 50 or over** (n=679)
Reported growing in the past 12 months	**78.5%**	**49.9%**
Expect to grow in the next 12 months	**79.1%**	**53.3%**
Expect their local economy to grow in the next 12 months	**70.5%**	**46.8%**
Increased employee numbers in the past 12 months	**43.8%**	**12.8%**
Expect to introduce a new product, service or process unique to their market or the world	**28.9%**	**9.7%**
Expect revenue from overseas markets to grow strongly	**23.9%**	**7.7%**
Did **NOT** use social media for business purposes	**9.8%**	**44.2%**
More than 10 per cent of revenue comes from online sales	**64.8%**	**23.4%**
More than 10 per cent of sales received through digital online payment platforms, such as AliPay, ApplePay and WeChat Pay	**58.9%**	**28.3%**
Consider it likely that their business will be cyberattacked in 2018	**51.0%**	**29.7%**
Customer loyalty had the most positive impact on their business in the past 12 months	**34.2%**	**45.4%**
Required external finance in 2017	**72.2%**	**26.1%**
Investment in technology in 2017 has already increased the business's profitability	**65.3%**	**27.8%**

Implications for tax policy

While there are many policy factors outside of tax that can influence people to start a business, remain in a business and exit a business, the survey data shows that there may be advantages for the Board of Tax to consider, for example:

- tax measures that encourage people to start a small business, especially people under 40.
- making the current $20,000 instant asset write off a permanent feature of the tax system to help encourage more small businesses to invest in digital technologies.
- whether there is value in the government providing vouchers (or even some form of double deduction) to small businesses to help meet the costs of attending training designed to improve their understanding of digital technologies, exporting and business management skills.