

26 May 2014



**Institute of
Chartered Accountants
Australia**

Ms Teresa Dyson
Chair
The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600

Email: taxboard@treasury.gov.au

Dear Ms Dyson

Review of Impediments Facing Small Business

The Institute of Chartered Accountants Australia (the **Institute**) welcomes the opportunity to provide a submission to the Board of Taxation (the Board) to identify features in the tax system that are hindering or preventing small businesses from reaching their commercial goals.

About the Institute

The Institute represents accounting and business professionals in Australia and around the globe. Members strive to uphold financial integrity through a commitment to ethics and acting in the public interest.

We focus on educating candidates through the Chartered Accountants Program and engage in advocacy and thought leadership underpinned by our members' knowledge and experience. We influence a range of policy areas impacting the Australian economy and domestic and international capital markets.

A watershed member vote in 2013 set the course for the Institute to amalgamate with the New Zealand Institute of Chartered Accountants, subject to obtaining formal government approvals and effecting amendments to constituent documents. The proposed new institute – Chartered Accountants Australia and New Zealand – is expected to have more than 90,000 members in total with over 17,000 candidates, giving us greater scale and influence on the world stage.

Our submission

We note that this is a fast-track review with a reporting date of 31 August 2014, and although some input has been received from members with a keen interest in small business issues, we have not had sufficient time to survey our broader membership.

Our comments are therefore of a general, high level nature. Accordingly, we invite the Board to meet with the Institute to workshop various issues raised in the submission if it assists.

Given that the Board has also been asked in its Terms of Reference to work closely with the Treasury and Australian Taxation Office (ATO) in preparing its report, our submission also identifies recent consultations between the Institute and the ATO on issues related to small business, and the contact name of the relevant officials responsible for those discussions.

Customer Service Centre
1300 137 322

NSW
33 Erskine Street
Sydney NSW 2000

GPO Box 9985
Sydney NSW 2001
Phone 61 2 9290 1344
Fax 61 2 9262 1512

ACT
L10, 60 Marcus Clarke Street
Canberra ACT 2601

GPO Box 9985
Canberra ACT 2601
Phone 61 2 6122 6100
Fax 61 2 6122 6122

Qld
L32, 345 Queen Street,
Brisbane Qld 4000

GPO Box 9985
Brisbane Qld 4001
Phone 61 7 3233 6500
Fax 61 7 3233 6555

SA / NT
L29, 91 King William Street
Adelaide SA 5000

GPO Box 9985
Adelaide SA 5001
Phone 61 8 8113 5500
Fax 61 8 8231 1982

Vic / Tas
L3, 600 Bourke Street
Melbourne Vic 3000

GPO Box 9985
Melbourne Vic 3001
Phone 61 3 9641 7400
Fax 61 3 9670 3143

WA
L11, 2 Mill Street
Perth WA 6000

GPO Box 9985
Perth WA 6848
Phone 61 8 9420 0400
Fax 61 8 9321 5141

Our submission is attached as Appendix A.

Small business compliance costs – Our latest contribution to the research

Our latest sponsored research on tax compliance costs for small to medium enterprises (SMEs) in Australia was undertaken as part of an Australian Research Council (ARC) Linkage project on tax system complexity, with a multi-university research team. The Institute was the Industry Partner in this project and the ATO provided support in terms of sample selection and provision of macro-level tax data.

The survey focused on enterprises with annual turnover less than or equal to \$250 million and looked at the tax compliance burden imposed by federal and state taxes during the 2012 tax year.

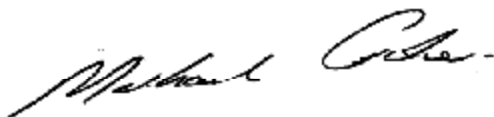
Gross tax compliance costs were analysed, including internal staff time spent on tax compliance and external adviser costs, but excluding incidental costs (such as costs of premises) and psychological costs (the stress and anxiety of having to deal with tax matters).

The survey's results indicated that the average gross tax compliance costs for businesses in the SME sector were about \$11,000 per firm per year, an increase of 118 per cent in constant dollar terms since the last major Australian study of SME tax compliance costs in 1995, with less than half of that increase accounted for by the introduction of the GST. Statistical analysis confirmed that business size remains the single most significant predictor of tax compliance costs: average gross compliance costs in absolute terms increased as the firm grew in size: about \$3,400 for a micro-business (annual turnover less than \$75,000); \$12,000 for a small entity (annual turnover: \$75,000 - \$1,999,999); and \$55,000 for a medium sized entity (annual turnover \$2 million - \$50 million). However, the compliance burden measured as a proportion of turnover was much more significant for micro businesses (\$90 per \$1,000 of turnover) than for small businesses (\$12) or medium sized entities (\$2), confirming the regressivity of tax compliance costs. Aggregate gross compliance costs for the SME sector were estimated at a little over \$18 billion, representing 1.2 per cent of GDP and 14 per cent of tax revenue.

While business size is the main factor determining the magnitude of tax compliance costs at firm level, the number of taxes (both federal and state) is also a significant determinant irrespective of firm size. In addition, there is a clear perception among SMEs that the complexity of tax laws, the frequency of tax changes and the administrative requirements imposed by the ATO are significant drivers of tax compliance costs for their business. This perception was particularly strong among medium sized entities, as was the opinion that compliance with obligations imposed by state/territory taxes (for example payroll tax) was especially costly.

If you would like to discuss any aspect of our submission please contact me on (02) 9290 5609.

Yours sincerely



Michael Croker
Head of Tax Policy
Institute of Chartered Accountants Australia

Appendix A

Introduction

The Institute notes at the outset that the Board's Terms of Reference do not question, in a tax reform or tax expenditure sense, the policy foundations for the current tax concessions provided to small business in the tax law. Nor are we asked to consider the justification for the administrative arrangements provided to this sector by the Australian Taxation Office which are designed to make tax compliance easier.

In other words, we take it as given that the government regards small business as a sector which for a range of reasons is deserving of special tax consideration¹.

However, we note at the outset that *other* taxpayer categories (large business, individual taxpayers) might also welcome some of the concessional tax or administrative arrangements available for small business, as well as ideas canvassed in our submission.

The Institute also believes that additional small business concessions are no substitute for simplifying the tax system as a whole. In this regard, a significant structural issue for the Australian tax system (particularly small business) is the divergence between the company tax rate and the top marginal rate that applies to income from labour.

The Board has on previous occasions reviewed the impact of the current tax system on small business, particularly in its [Scoping study of small business tax compliance costs: A report to the Treasurer](#) (December 2007), and no doubt this earlier work will be taken into account by the Board in the current review.

Finally, and despite the recent focus on red tape reduction, the Institute is also aware that deregulation – although well intended – can sometimes increase the burden on small business particularly where accompanied by complex eligibility requirements and anti-avoidance safeguards.

General comments

What is a 'small' business?

The Institute has long advocated a simpler definition of 'small business' which should be applied consistently throughout tax legislation.

In 2006, we sponsored research on this topic by the University of New South Wales which remains relevant to the Board's current project². We commend this research paper – which can be accessed from the Institute's [website](#) – to the Board.

¹ The policy rationale for small business concessions usually includes one or more of the following: the contribution small business makes to economic growth, enhanced competition and job creation; the need to counteract market failure; countering the disadvantages of being 'small' (particularly regressive compliance costs, asymmetric treatment of taxable profits and losses); the need to transition family businesses through circumstances relating to the owners which could jeopardise the business activity.

² Institute of Chartered Accountants in Australia, [Research and recommendations on definition of small business](#), January 2006. (Authors: Associate Professor Neil Warren, Senior Lecturer Garry Payne and Senior Lecturer Helen Hodgson of Atax, Faculty of Law, the University of New South Wales, Sydney.)

Although some improvements to the tax law dealing with the definition of small business have been made since the report was published, the Institute feels that some of the remaining proposals put forward by the authors deserve consideration, including:

- The creation of a 'whole of government' approach to the definition of small business which would see the enactment of a separate definitional Act (e.g. named the Small Business (Definition) Act 2014) relevant to tax and other areas of government administration, such as eligibility for small business grants, collection of statistics etc
- A review of current rules for identifying a small business 'group' for determining eligibility for concessions
- The automatic indexation of small business eligibility thresholds (e.g. turnover and asset amounts) so that access to the concessions is maintained for small businesses established in the future.

The current small business thresholds

It would be appropriate for the Board to revisit the \$2 million aggregated turnover threshold to be a small business entity under Division 328 of the ITAA 1997, as well as the \$6 million net asset value test, and determine whether it should be increased. The Henry Review recommended that the \$2 million threshold should be increased to \$5 million and said consideration should be given to adjusting the \$6 million net asset value test under the small business CGT concessions (Recommendation 30).

The Australian Taxation Office and small business

The Institute actively participates in a number of forums sponsored by the Australian Taxation Office (ATO), but in the context of this submission, we contribute to the:

- Small Business Liaison Group
- Indirect Taxes Advisory Group.

Recent discussions for these groups have focused on compliance cost reduction issues and enhanced ATO service offerings to the small business sector, and we expect that the Board will receive input from the ATO Chairs for these Groups (Mr Steve Vesperman and Mr James O'Halloran) in preparing its report.

At a broader level, we are aware of plans already instigated by the Commissioner of Taxation, Chris Jordan, to develop a more streamlined ATO service offering which will see, by the year 2020³:

- Greater use of technology to make the inter-action between taxpayers (including small business) and the ATO faster and much more efficient
- Enhanced data collection and data analytics which will enable the ATO to use better risk identification techniques so that compliant small businesses will receive the so-called 'light-touch' approach (e.g. there will be less ATO-initiated disruption to such businesses in areas such as risk reviews, audits etc)

We support the broad direction of the Commissioner's plans.

³ Referred to within the ATO as the '2020 Vision'.

Standard Business Reporting

Standard Business Reporting (SBR) is seen by the ATO and other government agencies at both Federal and State level as a key driver for lowering future compliance costs, particularly for small business.

We agree that SBR has great potential. For that reason many implementation issues associated with the expansion of SBR deserve greater focus from government, both Federal and State. These include:

- An agreed, staged implementation timeframe determined in association with leading small business associations, accounting and book-keeping bodies which will set a target date for *full* SBR implementation as part of an overall 'e-government' strategy
- The availability of small business concessions to acknowledge the costs associated with SBR implementation (e.g. a possible 100% write-off for technology-related expenditure – up to a specified amount – where there is a clear nexus to the implementation of SBR)⁴
- Other incentives could be provided at an administrative level, such as modest ATO lodgement or payment extensions for SBR users
- Additional government support on promoting SBR and small business owner education, in keeping with Recommendation 127 of the Henry Review (although we acknowledge that, if a full SBR implementation timeframe is published, normal market forces will see software companies ramp-up their existing marketing and education SBR spend)

ATO communications with small business – A portal or dashboard approach

Because small business owners are typically time poor, they often find it difficult to deal with ATO communications (e.g. newsletters, payment reminders etc). The more important communications – such as those relating to business activity statements (BASs) and income tax returns – are often received via their tax agent, and small businesses often rely on their tax advisers to communicate the key tax information they need to know (such as the announcement by the government of a new tax incentive relevant to their business).

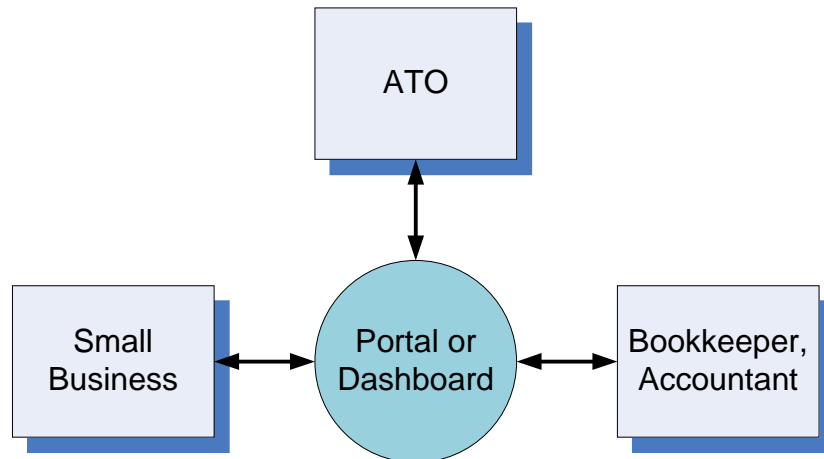
As part of the ATO's 2020 Vision referred to earlier, the Institute was recently involved in a workshop designed to consider how the ATO can improve its communications with small business, particularly through the use of technology. The ATO contact for this project is Mr Steve Vesperman.

The Institute supports this ATO initiative, and favours the creation of an expanded portal which small business owners can set-up to better manage their tax affairs and send and receive communications relevant to their business and industry profile. In the United Kingdom for example, a [Business Tax Dashboard](#) has been developed by HMRC targeted at the small business market. It gives small business 'at a glance' insights to the various business taxes for which the business is registered, payment information, and links to useful information.

We favour the portal (or dashboard) model because busy small business owners are unlikely to have the time to regularly visit and read a special small business news site located on the public ATO website containing generic tax information: they need information specifically targeted to their business and industry. An introductory taxpayer profiling questionnaire could help tailor the portal to the taxpayer's specific information needs.

⁴ We note the unfairness that could result here. First movers who have already embraced SBR would feel disadvantaged from a concession that was available only a prospective basis. An across-the board incentive for all eligible small businesses (even those who can prove prior year outlays) might be considered necessary.

A portal also has the advantage of enabling the business owner to grant access rights to persons within the business (e.g. an in-house book-keeper) and externals such as an accountant so that this aspect of the client-adviser relationship is also streamlined. We would expect that tax software developers could further enhance the portal concept if involved by the ATO in the design phase.



Source: Institute of Chartered Accountants Australia

Under a whole of government, digital by default approach, a portal also has the advantage of being expandable so that other government agencies (such as ASIC) can have 'pages' on the small business owner's portal where relevant.

We note too that email communications and data transfers through the portal or dashboard may be more secure than, for example, the use of publicly available email software.

We look forward to working with the ATO as it further develops its thinking in this area.

Identity verification to the ATO

The ATO's statutory obligation to protect taxpayer secrecy means that taxpayers and their advisers need to work through proof-of-identity procedures before they can engage with the ATO on matters relevant to the tax affairs of the particular taxpayer. For small business, these procedures also cause problems because the conversation with the ATO will often involve the business entity and the business owners (i.e. separate taxpayers).

Recent consultations with the ATO indicate that a voice authentication project is well underway, and the technology is such that – once a 'voice' is registered – the user will automatically be identified in future interactions with the ATO. The project leader for this initiative is Mr David Diment.

We welcome this initiative and look forward to the roll-out. However, personnel changes at small business level and in the staff employed by tax intermediaries such as accountants mean that new voice contacts will need to be authenticated on a regular basis with the ATO's system. Ideally, family business groups should be recognised so that the conversation with the ATO can, if necessary to resolve the issue, address both the business entity and the owners.

Identity assurance via the portal approach outlined above should also be a feature of the new ATO approach and, again, this ATO initiative should lead into a uniform whole of government approach to authentication.

Enhancing the ATO relationship with tax intermediaries

Given that many small businesses are reliant on tax intermediaries, enhancements to current ATO services should address both the relationship with the taxpayer and their representative. We believe that tax intermediaries currently play a very important role in making the tax system more efficient, and their skill in sorting out small business problems with the ATO should not be overlooked.

Specific comments

Small business tax concessions

The small business CGT concessions were the subject of a post-implementation review by the Board in October 2005⁵, with the Government of the day following up on many of the Board's recommendations.

It should be acknowledged at the outset that the existing concessions are generous. From a policy viewpoint, they are designed to reward risk-taking and acknowledge that a small business owner's retirement funding is often locked-up in the business.

Our members continue to report that the current eligibility requirements – particularly the rules in Subdivision 152-A – are overly complex. In part, this is because of the well-intentioned work of policy designers to cater for a wide variety of structures and asset-holding arrangements.

The Institute would welcome the opportunity to workshop the current eligibility requirements to explore ways in which they could be simplified.

Personal services income rules

The use of personal service companies continues to expand in line with the growth of flexible workplace arrangements. The motivation to incorporate is not driven solely by taxation savings although this is undoubtedly a factor and an on-going cause of concern, particularly because of the erosion of the PAYG withholding tax base.

The relevant law – Part 2-42 ITAA 1997 – is an example of how well-advised taxpayers can structure their arrangements from the outset and generally achieve their commercial goals (i.e. the establishment of a legitimate personal services business).

The main difficulty encountered in practice is where taxpayers have not received adequate advice during the establishment phase or, having received such advice, do not subsequently operate their business in the way envisioned by the various tests in the tax law.

Here again, it would be worthwhile to workshop how the existing tests could be simplified so that small business owners could be given (and regularly reminded of) 'bright line tests' for operating a personal services business. Improved technology and data matching could facilitate monitoring of compliance with certain tests such as the unrelated client and employment tests.

⁵ *A Post-implementation Review of the Quality and Effectiveness of the Small Business Capital Gains Tax Concessions in Division 152 of the Income Tax Assessment Act 1997 - A Report to the Treasurer*, Board of Taxation, October 2005.

Division 7A and small business

The Institute has recently [responded](#) to the request for input on the second discussion paper for the Board's post-implementation review of Division 7A of Part III of the Income Tax Assessment Act 1936 (ITAA 1936).

The points raised in our submission will not be repeated here, other than to say that a private company owned by shareholders which include a trust is a common small business operating structure. The Board's work and eventual recommendations to government on Division 7A – particularly in relation to the use of funds representing unpaid present entitlements to corporate beneficiaries as working capital – will be of great relevance to the small business sector.

A lower tax rate for 'active' small business companies, or the creation of a small business entity

As noted in the Institute's [pre-Budget submission](#) for 2014-15, the Australian company tax rate is high by world standards, and will remain so even when reduced to 28.5%.

Other countries have found ways to assist small business with a carefully targeted lower tax rate or flow-through concessions.

A lower rate approach

In Canada for example, the special circumstances of small business are recognised through a corporate tax reduction – known as the small business deduction – for active Canadian-controlled companies earning domestic income. The deduction provides for an 11% federal tax rate on active business income capped at \$500,000.

In a policy sense, the concession is designed to:

- Recognise the special financing difficulties facing small business (higher cost of capital)
- Free up more after tax income for reinvestment and expansion.

The concept of an active small business is already used in the CGT small business concessions.

Apart from the tax expenditure associated with the lower rate approach, there are clearly a range of difficult design issues with this policy, including eligibility thresholds, the need for a robust 'active income test', and anti-avoidance safeguards.

We suspect that this is an idea more suited to consultations on the government's proposed White Paper on tax Reform.

A small business entity approach

Other countries have also developed flow-through treatment for eligible small business entities.

An example is the United States, with its S-Corporations. Under such regimes, instead of the entity being taxed, the tax effect of transactions would 'flow through' to the ultimate owners of the entity. Essentially, this results in the operating entity being ignored for tax purposes.

The Institute, in association with Deloitte, considered a small business entity flow through taxation regime in a [report](#) prepared in April 2008. If the Board considers that such a regime is worthy of consideration in the current review, we would be happy to canvass the issues raised in that report.

We note however that the Henry Review concluded that a flow-through regime for closely held companies and fixed trusts should not be adopted for the time being, but could be considered if Australia moved away from the dividend imputation system (Recommendation 38). Again, this issue is probably best left to consultations on the White Paper on Tax Reform.

Disincorporation relief

Another barrier to small business re-structuring in Australia is the lack of disincorporation rollover relief to transfer assets back into the owner's hands (e.g. once a business ceases and asset protection is no longer a factor, or to facilitate succession planning).

Such relief would defer recognition of gains by negating the operation of the CGT market value substitution rule in dealings between related persons, and provide for CGT cost base inheritance by the transferee.

In the United Kingdom for example, such relief applies where a 'qualifying transfer' meets all of the following conditions:

- the business must be transferred as a going concern
- the business must be transferred together with all the assets of the business or together with all the assets of the business apart from cash
- the total market value of the qualifying assets at the time of the transfer must not be more than £100,000
- the shareholders that the business is transferred to must be individuals
- those shareholders must have held shares in the company throughout the 12 months before the transfer.

Qualifying assets are interest in land (other than land held as trading stock) and goodwill.

Disincorporation relief for small business again raises numerous questions in the context of the Australian tax system and could perhaps be considered in the context of the White Paper on Tax Reform.

Unincorporated small business

For those small businesses which are unincorporated:

- The promised reduction in the company tax rate will not apply
- Specific income tax substantiation rules apply, whereas none are required for other business structures (although special rules apply to partnerships)
- Income splitting is not as flexible as with other structures.

The fact that tax outcomes vary depending on the structure chosen to conduct a business is a well-known feature of our tax system, and we acknowledge that sole traders and partnerships do enjoy some tax benefits (such as immediate and unrestricted access to tax losses) that non-transparent tax entities cannot.

Substantiation rules in the income tax law

One idea which the Board could consider is to remove the application of *specific* income tax statutory substantiation rules to sole traders and partnerships (e.g. car expenses, travel diaries). In practice, all businesses are subject to record keeping obligations and normal good commercial practice means that records are generally kept, often using technology (e.g. fleet card records of vehicle expenses). The introduction of GST has also had a favourable impact on small business record-keeping. In these circumstances, it seems inappropriate for a sole trader or business partnership to be tripped-up by technical non-compliance with the substantiation provisions.

If small business record-keeping remains a concern of the ATO, then we commend the 'modern' approach to [electronic records](#) recently adopted by HM Revenue & Customs (HMRC). HMRC lists software suppliers who have developed simple small business record keeping applications following consultation. Many of these applications are free and although not endorsed by HMRC, their use is encouraged.

Capital allowance – Small business concessions

The Institute supports the Henry Review's Recommendation 28 to increase the threshold for depreciating assets that small businesses can immediately write-off to \$10,000. This recommendation was prompted by a desire to provide cash flow benefits for the small business sector and simplify their capital allowance calculations.

In the current fiscal climate, and in view of the recent decision by the Coalition government to introduce legislation lowering the small business instant asset write-off from \$6,500 to \$1,000 and withdraw special rules for vehicle depreciation, this seems like a cause which might best be taken up again in the promised White Paper on Tax Reform.

Trusts

As noted by the Henry Review, the rules around the taxation of trusts need to be updated and rewritten to reduce complexity (Recommendation 36) and we expect this to be on the agenda for the White Paper on Tax Reform.

For small business in particular, greater flexibility for trusts to restructure their business affairs within a family group without triggering tax liabilities would be achieved by extending tax roll-over relief.

The Board should also review the tax compliance and complexity that currently arises from the making of a family trust election and interposed entity election. Such elections are commonly made by small businesses and there is a general view within the tax practitioner community that the risk to revenue has been addressed by measures which are unduly complex and difficult to apply in practice.

Safe harbour approaches for small business

Safe harbour approaches in the tax law give eligible taxpayers certainty of tax outcomes and lower compliance costs.

For example, the distinction between capital and revenue expenditure for tax purposes can sometimes be difficult for all businesses and their advisers. One way of addressing this difficulty for a small business which would otherwise need advice on the matter from a tax adviser would be to allow a 'safe harbour' deduction for any legal expense which does not exceed a maximum annual amount (e.g. \$10,000). A deduction claimed for legal expenses exceeding this amount (e.g.

\$15,000) would need to be supported by consideration of the capital-revenue distinction for the full amount claimed (i.e. \$15,000). In keeping with current law, deductible expenditure would be excluded from the cost base of CGT assets.

The Institute supports the greater use of 'safe harbours' for eligible small businesses but notes that the tax expenditure associated with such measures would need to be first modelled and costed by Treasury. It may also create a clamour for comparable treatment from other taxpayer categories.

Other areas of the tax where a safe harbour approach could be considered for small business include:

(a) *Home office expenses*

Many small business owners use an area set aside in the family home for work purposes but the current tax law and ATO guidance on the deductibility of such expenses is somewhat complex and in practice requires evidence of the calculation and the keeping of invoices⁶.

(b) *Transfer pricing*

It is unclear whether current ATO transfer pricing activity extends down to the size of small business under consideration by the Board in its current review, although the ATO has certainly indicated that transfer pricing risk is no longer just a large business issue. The Institute is aware that the ATO – in a project led by Mr Mark Konza – is currently investigating whether 'safe harbour' transfer pricing guidance can be developed for the small business sector. For example, the ATO is considering whether small business will be protected if they adopt one of the more straightforward transfer pricing methodologies for setting prices. The type of small business transfer pricing documentation expected by the ATO will hopefully also be made clearer. The Institute supports this work and our members who specialize in transfer pricing will contribute to the development of ATO thinking in this area.

Administrative safe harbours and the ATO

The ATO should also think of ways in which it can offer small business 'safe harbours' from penalties and interest.

An example we would put forward for consideration is the 'employee-contractor' problem.

As the ATO [website](#) makes clear in plain English (which reflects the very complex law and administrative guidance that supports the ATO views), it is the business \ payer who must determine whether a new worker \ payee is an employee or contractor. This is meant to be done by the business \ payer looking at the whole working arrangement and applying tests – largely developed by the judiciary and enshrined in tax rulings – which themselves are not definitive (indeed, the outcome can still be highly uncertain and is sometimes litigated).

Importantly, a worker is not automatically a contractor just because he or she has obtained an Australian Business Number (ABN). In a sense, the government does not 'stand behind' or warrant the decision to grant an ABN to the worker \ payee.

The business \ payer is meant to keep records to support the employee-contractor decision in relation to various taxes (income tax in the form of PAYG withholding, Superannuation Guarantee, FBT and/or payroll tax). Penalties and interest are imposed *on the business \ payer* if the decision to

⁶ Refer s. 8-1 ITAA 1997 and TR 93/30, the leading ATO ruling on the topic.

categorise the worker as a contractor proves incorrect. GST is also likely to have been incorrectly applied and calculated.

The ATO provides a helpful [employee \ contractor decision tool](#) on its website, and guidance is also available from State Revenue Offices.

The contractor-employee problem is highly relevant to the small business community in two respects:

- The business \ payer is liable (as explained above), and small businesses in particular are not well equipped to work through and apply the various tests which seek to categorise the worker \ payee as either a contractor or employee
- The worker \ payee who claims to be a contractor (who is also a small business owner) may be frequently challenged by payers about their tax status, and will often hear the suggestion that he or she should operate as an incorporated entity or use a trust (which itself raises issues under the personal services income anti-avoidance rules in the ITAA 1997).

The problem is particularly acute in certain industries, such as construction.

The Institute submits to the Board that, if a small business has verified the worker \ payee ABN online using the Australian Business Register, worked through the ATO decision making tool, and kept a record that all of this has been done, then the ATO should not impose penalties and interest on the business \ payer if the ATO concludes that the wrong decision has been made. Of course, no such relief should be available where the business \ payer does not operate on arm's length terms with the worker \ payee.

This idea highlights the way in which the ATO can increasingly think of itself as a service provider offering *certainty* to business, as distinct from an organisation that merely obtains input from taxpayers and other data providers and verifies compliance with complex law.

Higher thresholds for less frequent filing of tax data and payment to the ATO – pro's and cons

The Board will no doubt be asked to consider the desirability of increasing the current thresholds which are used in the tax law to determine whether a small business is eligible for additional time to lodge tax data and remit tax payments to the ATO.

Using PAYG withholding as an example, the current descriptions of 'large', 'medium' and 'small' withholder could be reviewed⁷.

But despite the obvious benefits for small business of lifting existing thresholds, the Institute notes that – over time – there are also valid tax policy reasons for closer alignment of all business tax payment arrangements (rather than maintaining the differentiation between businesses of different size). These include:

- Reducing the timeframe in which funds which rightly belong to the government (e.g. PAYG withheld from employee pay packets) are held by a small business in a bank account which generates income for the business – a benefit not enjoyed by other businesses
- Reducing the risk that such funds may be used inappropriately by the small business (e.g. to meet private expenses)

⁷ Refer s. 16-95 to s. 16-105 Taxation Administration Act 1953.

- Enabling the ATO to obtain better real-time data indicating whether a small business is experiencing difficulty in meeting its tax payment and lodgement obligations (i.e. warning signs)
- The impact of electronic remittance and lodgement procedures to streamline compliance
- To foster improved, efficient, business-like practices within the small business sector.

On balance, we would caution against increasing current eligibility thresholds for small business concessional payment and lodgement arrangements.

ATO management of small business tax debts

It is generally the case that small business has less negotiating power than larger organisations when it comes to being paid for goods or services provided. Smaller firms are less likely to employ in-house financial managers, and may be under-capitalised. Difficult economic conditions can push a small business to the brink very quickly and tax payments represent a major outgoing. Their ability to borrow to pay tax (e.g. using overdraft facilities) is usually limited, and often subject to review by the lender.

It is hardly surprising therefore that much of the ATO's work on debt management involves the smaller end of the business spectrum. The ATO has indicated that small business accounts for 10% of tax collected, but in excess of 60% of overdue debt owed⁸.

The Australian tax law already reflects a range of features designed to help small business with tax payments, such as:

- The ability to pay by instalments rather than as a lump sum
- A standardised approach which collates relevant taxes (or adjustments in the taxpayer's favour) into one overall payment via the BAS
- Longer periods between the accrual of the tax liability and payment.

The Institute is aware that the ATO is currently reviewing whether it can improve the way in which it manages small business tax debts. This review includes a survey of businesses to ascertain the factors (both positive and negative) which impact business behaviour. As part of this review, we have contacted the ATO Deputy Commissioner (Debt), Ms Cheryl-Lea Field, to offer our members' insights should there be an opportunity.

Our position is that the broader business advisory skills of accountants can be highly effective in improving tax debt management if there is a collaborative tri-partite working relationship involving the business owner(s) and the ATO.

With small business, the Institute also understands the difficulty the ATO faces in this highly sensitive area of its operations. Our membership includes those who advise small business and also members who specialise in insolvency and business turn-around work.

- On the one hand, ATO processes and procedures – and the commercial knowledge and inter-personal skills of ATO officers working in debt management – need to be of a very high standard. Many entrepreneurs encounter difficulties particularly during the initial years and, as a community, we need to help start-up businesses because of the enormous flow-on benefits that a successful business brings to our society. Due to its data collection

⁸ *It's about time*, Speech by Commissioner of Taxation to National Small Business Summit, Brisbane, 25 July 2013.

capabilities, the ATO is in a unique position to intervene early and effectively to develop strategies (e.g. a tax payment plan) to work-around temporary problems.

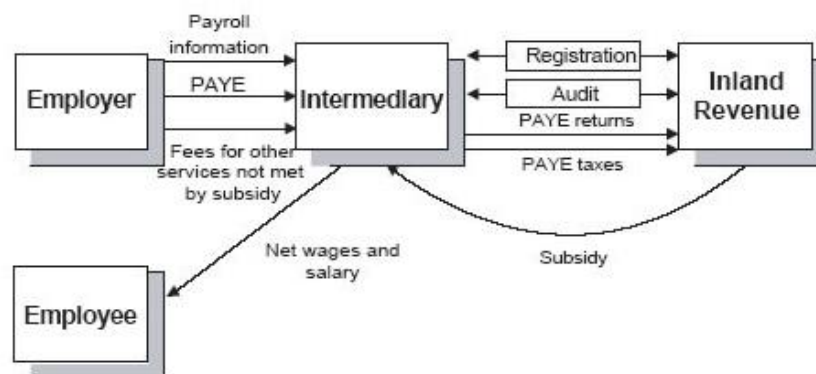
- However, those same data collection capabilities and follow-up contact also enable the ATO to act early to protect the revenue base (e.g. where PAYG withheld from employee's and GST are being used to prop-up a business which is clearly failing, or worse, the owner(s) is misappropriating tax for private purposes). The interests of other creditors are, in a practical sense, also protected by a vigilant ATO.

The Institute does not yet know what possible improvements the ATO might make to its current debt management practices and, in view of the Inspector-General of Taxation's *Review into the ATO's approach to debt collection*⁹ as well, we think it appropriate for the Board to ask the Inspector-General to prioritise this particular project and report his findings to government at the earliest opportunity.

Government subsidy to encourage the use of intermediaries which facilitate tax compliance and reduce tax debts

One idea that has been implemented in New Zealand to facilitate compliance and on-time payment of tax debts is the use of government subsidies to small business to encourage them to use specialist [payroll intermediaries](#) which assist with tax compliance. The New Zealand legislation¹⁰ enables Inland Revenue to subsidise the use of payroll agents to meet the PAYE obligations of small businesses.

The diagram below seeks to summarise the arrangement which attracts the subsidy in New Zealand.



This could be a model worthy of consideration by the Board in an Australian context and the Institute is happy to discuss design issues in association with our colleagues in the New Zealand Institute's Tax Policy Team.

Announced but unenacted measures – Small business measures

The Institute was disappointed to see that the 2014-15 Federal Budget failed to adjust the repeal date of the small business measures (instant asset write-off and motor vehicle concession) stalled in the Senate.

⁹ Note that this topic will be the subject of a review by the Inspector-General of Taxation (IGOT). Refer [Review into the ATO's approach to debt collection](#), Terms of reference, IGOT website.

¹⁰ *Taxation (Depreciation, Payment Dates Alignment, FBT and Miscellaneous Provisions) Act 2006 (NZ)*.

The same comment applies to the repeal of the loss carry-back measure which, although not a measure targeted at small business, was recommended by the Henry Review (Recommendation 31) and is primarily relevant to the small business sector because of the cap that applies to the concession¹¹. Although linked to the repeal of the Minerals Resource Rent Tax, the government could consider a change of tack and allow small business (as defined) continued access to loss carry back.

With the 2014 tax return season about to get underway, we expect our members will apply the law as it stands and the government should make clear that no amendment for the year ended 30 June 2014 will be required. The ATO has also provided guidance which indicates a 'no-harm' penalty and interest approach in such cases. Even with this clarification however, taxpayers will still have been impacted by the uncertainty surrounding the measures (e.g. depreciating assets may not have been purchased after 31 December 2013 because of the government's announcement).

The Institute understands that this issue reflects broader problems such as the increasing difficulty in amending complex tax law, lack of legislative drafting resources and allocating time for new legislation in the parliamentary timetable.

If these kinds of situations continue however, it won't be too long before another lengthy list of announced but unenacted measures develops under the stewardship of the current Coalition government.

The Institute has previously provided a [submission](#) to government and senior Treasury officials on ways to improve the legislative design, development and implementation process. We remain disappointed that our efforts on this front appear to be in vain.

Goods and Services Tax (GST)

(a) GST compulsory registration threshold

An entity is required to register if its GST turnover meets the 'registration turnover threshold'. The current registration turnover threshold is \$75,000. Businesses with GST turnover below this amount, may voluntarily register for GST, but it is not compulsory. Increasing the compulsory GST registration threshold would therefore allow the smallest businesses in Australia to elect to remain outside of the GST compliance system.

A consequential reduction in administration costs to the ATO may also be expected to the extent that the ATO is dealing with a smaller number of GST registered small businesses and their BAS returns.

The only occasion on which the registration turnover threshold has been revisited, since introduction of the GST in 2000, was in the 2007 Budget when the threshold was increased from the original \$50,000 to the current \$75,000 with effect from 1 July 2007.

According to the Treasurer's Press Release (No. 038 of 8 May 2007 titled *Simpler Tax for Small Business*), the 2007 Budget measures in relation to small business were directed at assisting some two million small businesses, or approximately 95% of all Australian businesses, by reducing red tape and compliance costs.

Given that a further seven years have now passed since the last recalibration of the registration threshold, we believe that it may now be timely once again to reconsider the level of the threshold to ensure that it is appropriate in real terms, i.e. that the appropriate micro-sized businesses can continue to

¹¹ The carry back of tax losses is extremely beneficial because it allows a small business to obtain cash refunds of tax already paid to the ATO.

have the option of remaining unregistered should they choose to do, as a means of simplifying their tax compliance obligations.

The government may also wish to consider an increase to the registration threshold beyond what is required to account for inflation firstly to reduce compliance costs to business, and secondly because the threshold may be unlikely to be reviewed again for some years. This is consistent with the recommendation made in the *Taskforce on Reducing Regulatory Burdens on Business* report (released on 7 April 2006).

As this measure would involve a change to the GST base, it would again require the unanimous agreement of the States under section 11 of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*.

(b) Threshold for requiring a tax invoice for GST

GST-registered businesses are allowed to claim input tax credits for acquisitions with a GST-exclusive value of \$75 or less without the need for a 'tax invoice'.

Consistent with the discussion above, the last time when the \$75 threshold was revisited was in 2007, when it was increased from \$50 to \$75, with effect from 1 July 2007.

We consider that it is again timely to revisit whether it is appropriate to increase the \$75 threshold for requiring a tax invoice, with a view to reducing compliance costs to business.

(c) Deferred GST Scheme for Imports

Entities with a turnover below \$20m are entitled to lodge their BAS quarterly (or even annually if below \$2m turnover). This reduces their compliance cost and eases cash flow compared with larger business who must lodge their BAS monthly.

However, small businesses who wish to use the Deferred GST Scheme for Imports must lodge their BAS and pay their GST monthly.

Therefore, for a small business, while the effect of moving to the Deferred GST Scheme delays the GST liability on imports by 36 days (on average), it has the following negatives:

- It must complete and lodge twelve BAS a year rather than four;
- It lodges its BAS 21 days after month end rather than 28 days after quarter end;
- It lodges its December BAS by the 21st of January rather than the 28th of February
Its GST liability on sales is payable 36 days after invoicing rather than 73 days (on average) as previously. For example, for the June quarter, the average sale is on 15 May and the liability would otherwise be due on 28 July. SMEs are required to pay their GST liability on sales 37 days earlier (on average).

By contrast, for large business importers, the effect of moving to the Deferred GST Scheme is only positive.

To remove the above impediments for small business, we recommend that 'SME' companies and trusts (i.e. entities which typically cannot make private or domestic acquisitions) be entitled to continue to lodge their BAS and pay GST quarterly where they apply to use the Deferred GST Scheme for Imports.