



Review of Tax Impediments to Small Business  
Board of Taxation Secretariat  
C/- The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [taxboard@treasury.gov.au](mailto:taxboard@treasury.gov.au)

Dear Sir or Madam,

**RE: Review of Tax Impediments to Small Business**

Thank you for giving the Office of the NSW Small Business Commissioner the opportunity to comment on the Review of Tax Impediments to Small Business. We have reviewed the Government's Terms of Reference.

The Office of the NSW Small Business Commissioner was established in mid-2011 to support small businesses throughout NSW. Our role is to:

- provide dispute resolution services;
- speak up for small business within government; and
- deliver quality business advice through Small Biz Connect.

We are focused on improving the operating environment for small businesses within NSW. We therefore support looking to identify features of the tax system that are unreasonably or unnecessarily hindering or preventing small businesses from pursuing and achieving their commercial goals.

We offer the following comments on matters relevant to the review.

**Small Business Thresholds**

The Terms of Reference state that the 'Board should not feel constrained to use any specific definition of small business'. We understand the difficulties of defining what enterprises qualify as a small business. Variability in measures such as number of employees, revenue per employee, the use of contractors and the ebb and flow of turnover tend to frustrate attempts to define this class of business.

It appears in certain circumstances appropriate for there to be a definition however. In relation to taxation thresholds we support application of relevant guidance from the Henry Review.

Enterprises can qualify for small business tax concessions if they meet various criteria. The majority of tax concessions are available to a business with aggregate turnover below \$2 million. This threshold was established in 2007. As the threshold has been static for several years, enterprises may have lost access to small business concessions over time through bracket creep. The Henry Review relevantly recommended:



*The small business entity turnover threshold should be increased from \$2 million to \$5 million, and adjustments to the \$6 million net asset value test should be considered.*

We support an increase from \$2 million to \$5 million in turnover threshold for the purposes of removing the bracket creep effect, and providing increased tax relief to small business.

## **Compliance Costs**

Tax compliance costs represent the time, effort and financial costs taxpayers must bear to meet their taxation obligations over and above the cost of keeping records and accounts in the usual course of business.

Australian taxation compliance costs have a more significant impact on small businesses than on larger businesses. They are regressive, with a given cost imposing a proportionately higher impost for smaller businesses. When taxation compliance costs are expressed in relation to each \$1,000 of turnover for Australian businesses, the regressive pattern is clear:

- \$39.05 per \$1,000 for businesses with turnover up to \$1 million;
- \$19.54 per \$1,000 for businesses with turnover of \$1 million to \$3 million;
- \$8.50 per \$1,000 for businesses with turnover of \$3 million to \$6 million; and
- \$6.64 per \$1,000 for businesses with turnover in excess of \$6 million.<sup>1</sup>

There's general acknowledgement that compliance costs have a greater impact on small businesses than on larger businesses. Past governments have implemented tax concessions to produce favourable outcomes which fall into two main categories:

- i) concessions that provide a lower rate of taxation, or accelerated deduction, and
- ii) concessions that excuse the taxpayer from requirements otherwise imposed.

Over half of the time spent by businesses in complying with tax obligations in Australia is spent *recording information* needed for tax. GST administration is the largest single cause of compliance costs, responsible for 58% of internal tax compliance costs<sup>2</sup>.

Previous studies have acknowledged concerns relating to Business Activity Statement (BAS) completion, expressing a finding that 'the BAS is still regarded as the most annoying and time consuming tax compliance requirement for small businesses'<sup>3</sup>. Consideration may therefore be given to BAS format, explanatory materials, and frequency. We wouldn't support any increase in frequency beyond the current quarterly BAS reporting requirement applicable to small businesses.

We support Government efforts aimed at getting tax policy settings right for the small business sector and suggest particular consideration of the second category of concession described above, with any tax rule changes mindful of the benefits of simplicity and clarity of application.

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<sup>1</sup> John Hasseldine, Chris Evans, Ann Hansford, Philip Lignier, Sharon Smulders, Francois Vaillancourt, 'A comparative analysis of tax compliance costs and the role of special concessions and regimes for small businesses in Australia, Canada, South Africa and the United Kingdom' (2012)

<sup>2</sup> Ibid

<sup>3</sup> Board of Taxation, 'Scoping study of small business tax compliance costs', (A report to the Treasurer) December 2007



## Audit Selection

A BRW article<sup>4</sup> from late 2012 discussed a review by the Inspector-General of Taxation, Ali Noroozi, which recommended the ATO improve its risk identification and audit processes to ease unnecessary stress for compliant businesses.

In the 2009 Federal Budget, the Government allocated funding – from which \$9.965 million over four years (2009-2013) was used to develop small business benchmarks and conduct compliance activities based on the benchmarks. The small business benchmarking strategy was predicted to raise \$18.5 million<sup>5</sup>.

The small business benchmarks cover a range of businesses with turnover below \$15 million. The program therefore affects taxpayers from both the micro enterprise and small and medium enterprise (SME) segments.

Benchmarking strategy activities from January 2010 to April 2012 comprised 20,298 initiated cases, of which 2,420 resulted in an outcome – a 'strike rate' of 12%. The program raised liabilities of \$66.4 million – a higher than predicted return. In its 7,670 'correspondence audits', the ATO made adjustments in 24% of cases – a rate below that planned<sup>6</sup>.

'Small businesses and their representatives had raised concerns with me that the ATO's benchmark-based compliance activities were capturing compliant taxpayers resulting in unnecessary stress, extra compliance costs and time away from running their businesses' Mr Noroozi said<sup>7</sup>.

The Inspector-General made eleven recommendations to the ATO – with nine agreed in full and two in part. We particularly support implementation of the recommendations aimed at improving the ATO's risk identification and audit processes to exclude compliant taxpayers from audits, thereby minimising unnecessary compliance costs.

## Employee Share Schemes

While the former Government indicated its desire to encourage employee ownership on the basis that it improves alignment of employee and employer interests, the 2009 reforms to rules governing employee share schemes (ESS) provide no additional incentives and make access to concessions more difficult. A key policy challenge arises from the conflict between the desire to encourage employee ownership and the belief that employee ownership schemes are open to abuse as a vehicle for tax avoidance or evasion<sup>8</sup>.

We understand that any discount on the market value of share options is taxed, after concessions, at the employee's marginal income tax rate in the year of acquisition unless certain conditions are met. And, if the value of the shares has fallen as at the time of their actual disposal<sup>9</sup>, the employee isn't eligible for a tax refund per se, but would have a loss under the capital gains provisions. We suggest considering the benefits of deferring payment of tax until the year in which the employee has realised the value of their share options.

<sup>4</sup> Nassim Khadem, 'Almost 6000 small business taxpayers wrongly accused by ATO', BRW, 9 October 2012

<sup>5</sup> Inspector-General of Taxation, 'Review into the ATO's use of benchmarking to target the cash economy' (2012)

<sup>6</sup> Ibid

<sup>7</sup> Nassim Khadem, 'Almost 6000 small business taxpayers wrongly accused by ATO', BRW, 9 October 2012

<sup>8</sup> Ingrid Landau, Ann O'Connell, Ian Ramsay, 'Employee Share Schemes: Regulation and Policy'

<sup>9</sup> (Sale may be difficult in illiquid markets, if the shares fall in value, or in the event the company fails).



Shares in privately owned companies are illiquid. It can be difficult to establish their value and costly to obtain valuations in compliance with ESS rules. We suggest considering the benefits for unlisted companies of ascertaining share value from net asset value, as per their most recent financial statements.

Unlike large or established companies, start-ups and small businesses may not have sufficient cash flow to attract, retain and incentivise key employees. An ESS is one tool that start-ups could use to do so for lower upfront cost than a cash equivalent.

The Treasury issued an invitation to comment on ESS dated 21 January 2014. Submissions closed on 7 February 2014. We understand that issues raised in submissions to the consultation process are being considered within the context of the Prime Minister's Taskforce established to develop a National Industry Investment and Competitiveness Agenda, which is due to make recommendations to the Government by mid-2014.

We appreciate the opportunity to comment on the Review of Tax Impediments to Small Business. Should you wish to discuss any of the issues raised in this submission, please contact Murray Johnston, Principal Advisor, Advocacy on (02) 8222 4842.

Yours sincerely



*rs* **Robyn Hobbs OAM**  
**NSW Small Business Commissioner**

27 May 2014