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20 July 2018

Dr Mark Pizzacalla
Chair
Board of Taxation
The Treasury – Melbourne Office
Level 6, 120 Collins Street
Melbourne VIC 3121

Via Email: taxboard@treasury.gov.au

Dear Mark

Thank you for inviting the Chamber of Commerce and Industry of Western Australia (CCIWA) to contribute to the Board of Taxation's *Review of Small Business Tax Concessions*.

Please find attached a copy of CCIWA's submission for the review.

I trust that the submission is useful for your review and CCIWA looks forward to engaging the Board of Taxation Secretariat further once your initial findings are published.

If you have any questions regarding this submission, please contact Mr Justin Ashley, CCIWA Policy Manager on Justin.Ashley@cciwa.com or 08 9365 7416.

Yours sincerely

Chris Rodwell
Chief Executive Officer

Att

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Chamber of Commerce and Industry of Western Australia

Submission to the Board of Taxation

Review of Small Business Tax Concessions

20 July 2018

We believe in good business

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Contents

Summary of Recommendations

In undertaking its review into the tax concessions afforded to small business (the Review), the Chamber of Commerce and Industry of Western Australia (CCIWA) recommends that the Board of Taxation (the Board):

1. Adopt 'simplicity' and 'certainty' as the overriding principles to guide reforms to small business tax concessions and the tax system more broadly;
2. Consider the benefits of maintaining the $20,000 instant asset write-off as a permanent fixture in the suite of tax concessions available to small businesses;
3. To the extent practicable, aim fora broad-based approach to tax concessions that promotes tax neutrality instead of highly targeted concessions;
4. Consider mechanisms to harmonise the definition of 'small business' throughout Australia's taxation and regulatory framework;
5. Define a review period to ensure thresholds for concession eligibility remain relevant and do not create unintended consequences;
6. Explore whether 'turnover' is the best measure for determining concession eligibility;
7. Increase the existing reporting threshold for PAYG withholding obligations;
8. Consider the interaction between Federal and State tax regimes and their implications for small business, especially with regard to the burden imposed by payroll tax.

Introduction

CCIWA is the leading business association in Western Australia and has been the voice of business for more than 125 years. CCIWA represents employer members from across all regions and industries in Western Australia, including local chambers of commerce, industry associations and employers, particularly small and medium enterprises, both in the private and government sectors. Our mission is to make Western Australia the best place to live and do business.

CCIWA welcomes the Board's review of tax concessions for small business (the Review). Consultation with industry is important to ensure that the design of tax policy, legislation, administrative systems and supporting materials suits the needs of the small business community. Ensuring that Australia's business tax system is effective, efficient, and equitable is a high priority for CCIWA's members. This is especially the case with respect to CCIWA's small business members as they are often more exposed to poorly designed tax polices compared to larger enterprises.

Tax compliance costs have a proportionally greater effect on small businesses compared to larger businesses and this compliance burden appears to be growing over time. Reducing compliance costs and promoting certainty is vital to the Australian economy as the small business sector is a major contributor to growth and employment.

Additionally, government regulations and policies can place a disproportionate burden on smaller businesses, due to the significant fixed costs associated with compliance[1]. To level the playing field, governments make concessions to some polices and regulations that affect small businesses. CCIWA supports this prevailing approach as small businesses play a significant role in the economy and should not be subject to unduly burdensome regulations.

CCIWA generally supports the key principles of the Review, but urges caution regarding the Board's principle of focusing on greater targeting of concessions afforded to small businesses.

The Importance of the Small Business Community

Small businesses employ 45 per cent of the Australian labour force, more than the medium business sector (23%) and large business (32%). Of the 2.2 million actively trading businesses operating at the end of 2016-17 in Australia, most (98%) had an annual turnover of less than $2 million. Of these businesses, a quarter (25%) had a turnover less than $50,000, about one-third (35%) had turnover between $50,000 and $200,000 and a further one-third (34%) of businesses had an annual turnover between $200,000 and $2 million. A relatively small proportion (3%) of business had an annual turnover of $5 million or more [2].

Populist commentary generalises all business in the context of large corporations. This is fundamentally unrepresentative of the economy that is comprised of over two million businesses, the smallest cohort being large businesses. The economy is not limited to a group of large businesses residing on the ASX. Large businesses in

[1] Kauffman-RAND Institute for Entrepreneurship Public Policy (2007) *Is Special Regulatory Treatment for Small Business Working as Intended?*

[2] Australian Bureau of Statistics (2018) *Counts of Australian Businesses, including Entries and Exits. June 2013-June 2017*, Catalogue Number 8165.0.

Australia – those businesses employing more than 200 people – account for less than one per cent of employing businesses in the country[3].

Small businesses have been under considerable pressure to maintain viable operations and continued employment of staff in challenging economic conditions where operating margins have been eroded and growth constrained. By their very nature, small businesses are particularly sensitive to challenging economic conditions. This sensitivity is reflected in fact that only 69 per cent of micro-businesses (1-4 employees) survived the 2016-17 financial year, compared to four years ago when 90 per cent survived the 2013-14 financial year [Figure 1]. Rising operating costs were a hindrance to various industries in WA, with over half of businesses from mining (53%) and manufacturing (54%) considering it a major barrier to business development[4].

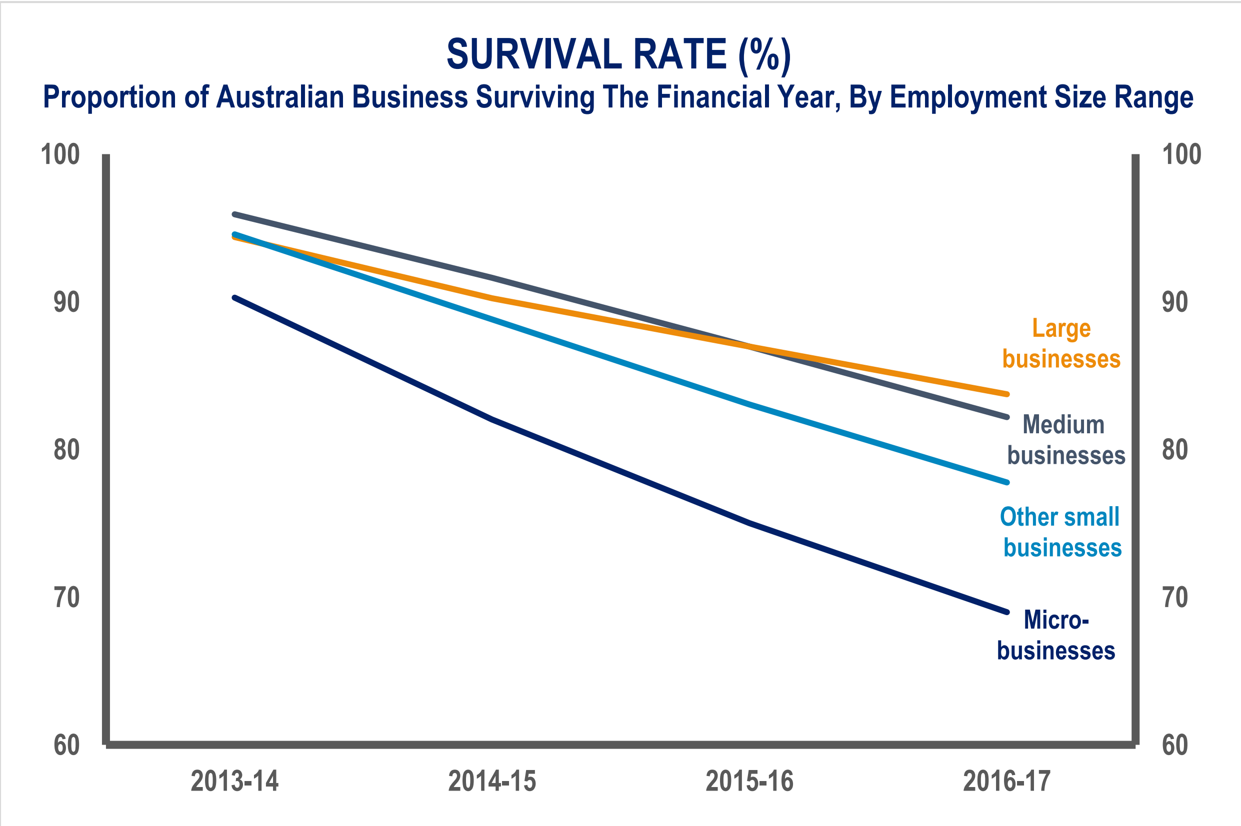

Figure 1: Survival Rate by Employment Size Range.
Source: Australian Bureau of Statistics (2018) Counts of Australian Businesses (Cat. 8165.0 Table 15).

[3] Ibid.
[4] Chamber of Commerce and Industry of Western Australia (2018) *WA Super – CCIWA Survey of Business Confidence, March 2018.*

Tax Issues That Are Concerning Small Businesses

Several consistent themes were identified during consultation with SMEs in preparation for this submission, with CCIWA members reporting tax compliance and cash flow management as the primary issues of concern for their business. Additionally, members expressed concern around the complexity of small business tax obligations and noted that they spend a sizeable number of hours per year ensuring that they comply with tax matters. The impact of complexity and burdensome compliance is discussed later in the submission.

While CCIWA members reported tax complexity as a significant concern, they have also reported actively choosing complex business structures as an attempt to reduce their tax liability. This suggests that the current tax regime for businesses is still placing an undue tax burden despite the various tax concessions. It is CCIWA's view that business structures should be 'tax-neutral' and incentivise businesses to select a business structure that is 'fit for purpose' rather than 'fit for tax purpose'.

How Do Small Businesses Value Current Tax Concessions?

CCIWA members consistently voice support for the $20,000 instant asset write-off provisions and concessional company tax rates for small business introduced in the 2015/16 Federal Budget. 64 per cent of small businesses surveyed regarded the lower company tax rate as a useful tax concession, while 67 per cent considered the instant asset write-off provision as useful [Figure 2][5].

The instant asset write-off concessions enable small businesses to instantly depreciate individual items costing $20,000 or less. This concession is especially useful for small enterprises in the start-up phase as it enables the purchase of critical capital equipment whilst reducing a business's exposure to cashflow issues. Furthermore, this measure provides important macroeconomic stimulus as it acts as a direct incentive for businesses to make capital investment, which can have far reaching economic benefits as the investment flows through the economy.

Economic considerations aside, the instant asset write-off provisions are an excellent example of effective small business tax concessions, as the measure is simple for businesses to understand and comply with, has broad public and social benefits, and little scope for the occurrence of unintended consequences that can plague more complex and targeted measures. CCIWA recommends that the Board consider the benefits of maintaining the $20,000 instant asset write-off as a permanent fixture in the suite of tax concessions available to small businesses. This would greatly promote certainty for small business.

[5] Chamber of Commerce and Industry of Western Australia (2018) *unpublished*.

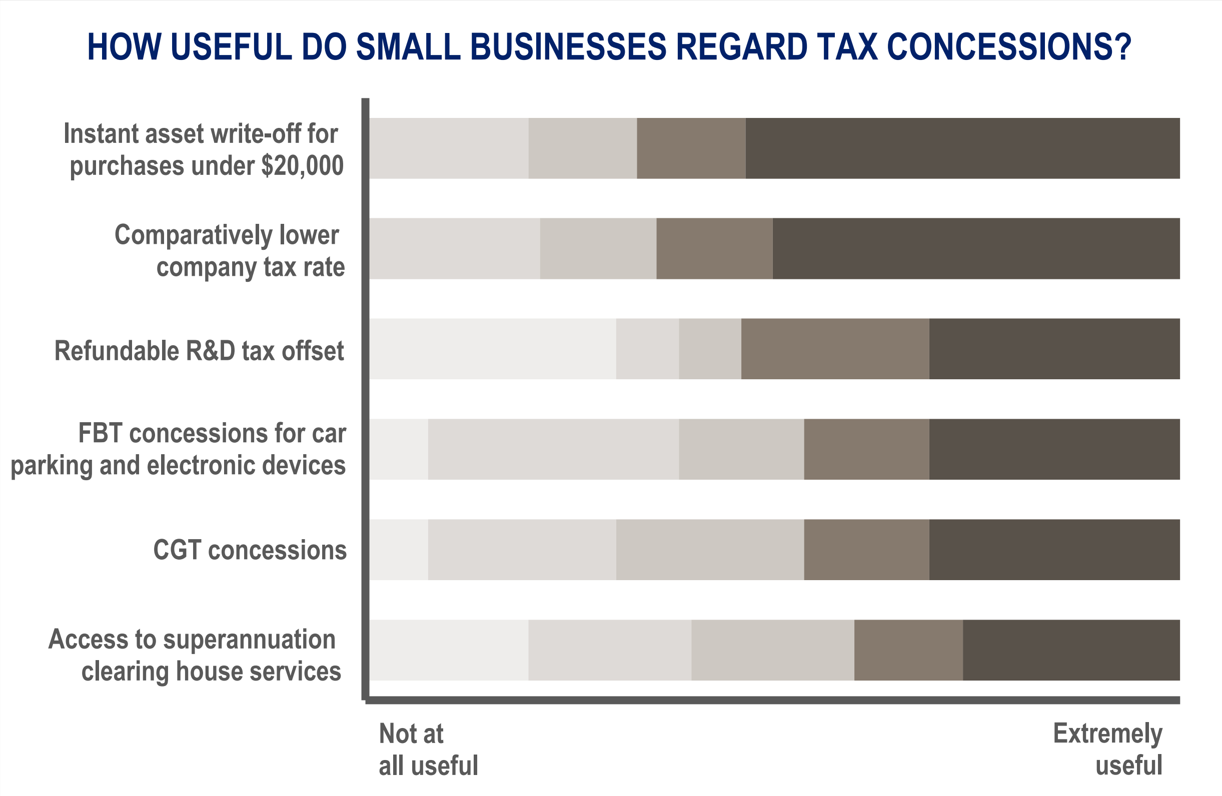

Figure 2: How Useful Do Small Businesses Regard Tax Concessions?
Source: Chamber of Commerce and Industry of Western Australia (2018), *unpublished*.

The definitional changes to 'small business entity' and the concessional corporate tax rate for small business introduced progressively over the 2015/2016 and 2016/2017 Federal Budgets is highly valued by CCIWA's SME members. Like the instant asset write-off provisions, the reductions in the tax rate are simple to understand, implement and provide a direct and immediate benefit to SMEs. Whilst the current concessions are no longer strictly confined to small business, these changes allow businesses to retain a greater portion of their profits. When combined with the $20,000 instant asset write-off rule, the concessional tax rate enables SMEs to place a greater investment into capital equipment and have the capacity to take on more staff.

Feedback from CCI's SME Members

"**The $20,000 immediate tax write off is a beneficial concession.** If we are purchasing an asset which results in the funds leaving our account, then the most reasonable and logical benefit is it to be able to account for that expenditure on the P&L in full. At the end of the day any revenue generated from said asset is going to be taxed. **I think this concession should never be revoked and the amount should be increased annually."**

Recommendations for Concessionary Approaches

Concessions Should Relieve the Compliance Burden for Small Business

Tax compliance costs represent the additional costs in terms of time, effort and financial expense that taxpayers must bear as part of meeting their taxation obligations, over and above the cost of keeping records and accounts as a normal part of carrying on a business.

Small businesses in WA regard business tax and activity statements as the most burdensome area of compliance[6]. Four out of five CCI small business members agreed that tax compliance obligations for small businesses are very complex[7].

The cost for small businesses to comply with tax requirements is significantly higher when compared to larger entities, given that smaller entities lack the economies of scale or in-house expertise compared to larger firms. The costs of compliance are regressive, with a given cost imposing a proportionately higher impost as the size of the business decreases. As such it is critical that any proposed reforms to tax concessions for small businesses be primarily focussed on ensuring simplicity of compliance.

Size, turnover and business structure influence the compliance costs of small businesses and they can vary over the life cycle of the business. Businesses that operate in the construction, catering, agricultural, and mining industries appear to experience significant non-tax regulatory compliance costs, as do businesses that operate across State and national boundaries[8]. Streamlining and achieving greater consistency across Commonwealth, State and Territory jurisdictions will assist in reducing regulatory burdens.

The time spent by CCIWA's SME members on tax-related matters ranged from two hours to 200 hours per year[9]. In the 2014/15 financial year, small businesses spent an average of 17 hours preparing their quarterly business activity statements (BAS) and annual tax returns[10] [Figure 3]. This equates to one hour spent on compliance matters per $155,606 earned. In comparison, medium-sized enterprises only need to spend one hour per $448,0003 earned on tax compliance activities. These numbers may understate the issue as these figures do not consider fees paid to accountants, bookkeepers and other financial advisers to assist in ensuring compliance, the time kept maintaining data required for tax compliance, or the non-financial costs associated with compliance (lost time and stress).

[6] Bankwest Curtin Economics Centre (2017) *The Engine Room for Growth?*
[7] Chamber of Commerce and Industry of Western Australia (2018) *unpublished*.
[8] Board of Taxation (2005) *Scoping Study of Small Business Tax Compliance Costs*.
[9] Chamber of Commerce and Industry of Western Australia (2018) *unpublished*.
[10] Australian Taxation Office (2017) *Taxation Statistics 2014-15*, Tables 2 and 3.

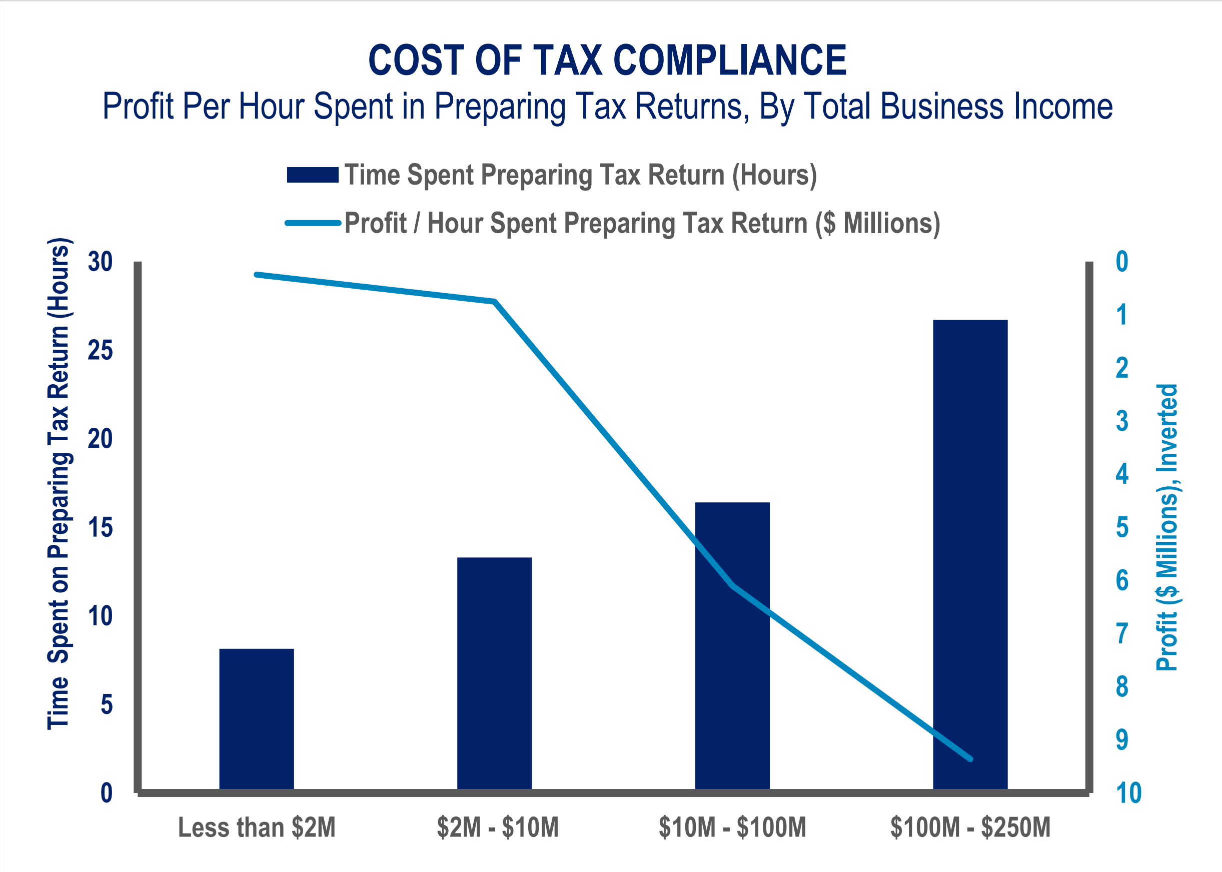

Figure 3: Cost of Tax Compliance
Source: Australian Taxation Office (2017) *Taxation Statistics 2014-15,* Tables 2 and 3.

The overall implication of this is that small businesses already bear a substantial burden when it comes to the cost of tax compliance. If compliance costs for small business are significantly higher relative to income it is unlikely that smaller entities will opt into concessional measures that are complex and time consuming. Conversely, simplifying compliance and reporting requirements for existing concessional measures will have an immediate positive effect for small businesses with little-to-no impact on the Government's revenue base.

Also adding to compliance costs is the need for small businesses to continuously monitor the tax law and adapt to any changes. This has a disproportionate impact on small businesses as they often do not have the expertise or funds to use advisors, such as tax experts, to maintain up-to-date knowledge of tax law.

The introduction of new concessions can add greater complexity as the boundaries between different taxes are shifted. This complexity further creates incentives for more sophisticated taxpayers to organise their affairs to benefit from interactions with the tax system, and small businesses can have limited capacity to comply with ever-changing complex laws.

Feedback from CCIWA's SME Members

"The **time, stress and cost in adhering to the tax rules is greater** than the costs associated with running the business."

"Reforms should **truly consider the negative and unnecessary stress that small business owners face** and the primary focus should be to find real improvements."

"Every time I employ someone there is an obvious cost – so if I can minimise my costs by doing what I am capable of doing, my business is slightly more effective. **Small business owners are often burdened with filling the gaps in their organisation, not because they want to, but because they have to**."

"**Keep the playing field fair**. Don't advantage those with specialist in-house accountants."

"**Every second spent keeping records, meeting with accountants to discuss tax, and expending money on expensive legal structures is resources being spent on something that adds no real value to Australia.** We are losing, and in some industries have already lost, the ability to compete on the world stage."

Concessions Should Not Be Highly Targeted

For highly targeted concessions to be effective and not create significant unintended consequences, decision-makers require highly granular data, backed up by rigorous analysis that leads to updates of concession rules on a regular basis. It is CCIWA's view that highly targeted concessions should be avoided due to the expense and inaccuracy of undertaking associated analysis, the undesirability of creating concessions to account for regionally specific situations and the inability for government policy to react swiftly to change.

The risk of misdirected targeting of incentives or concessions often has a far greater negative impact on individual businesses when compared to overall dilution of a specific measure. An additional negative affect arising from targeting rules to a specific group or a business size is that the targeting can act as a disincentive for businesses to grow or incentivise the proliferation of activity in a certain sector or group, this can lead to major distortions in the market place.

Tax concessions should not distort behaviour; arguably highly targeted concessions may be distortionary. As such neutrality should be pursued as a guiding principle when developing any tax concessions.

The Definition of 'Small Business' is Confusing

There is no single definition of 'small business', reflecting the diverse nature of small businesses and how they are currently regulated and taxed. For example, the Australian Bureau of Statistics (ABS) defines a small business as one employing fewer than 20 staff. Much of the tax law, including the Australian Taxation Office (ATO), defines a small business entity as a business with less than $10 million of aggregated turnover, while the Fair Work Ombudsman defines a small business employer as one with fewer than 15 employees. The Australian Securities and Investments Commission (ASIC) has an even more complex definition, requiring businesses to fulfil two out of three criteria to be classified as a small proprietary company.

'Small business' is defined differently by these regulators as they are each governed by various legislative instruments which are not harmonised. For instance, the *Corporations Act 2001* (Cth)[11] is administered by ASIC; the *Income Tax Assessment Act 1997* (Cth)[12] is administered by the ATO while Fair Work administers the *Fair Work Act 2009* (Cth)[13]. While some progress has been made in standardising the definition of 'small business' in law, there are still large inconsistencies which make it difficult to clearly define the boundaries of the small business sector. There would be merit in exploring the broader application of a standard definition across all legislation.

The varying definitions of 'small business' adds an unnecessary and additional layer of complexity to the regulatory environment that all businesses operate in. These differences can make it difficult for small businesses to be certain about their responsibilities and entitlements under the various regulatory regimes that guide their business behaviour. It can also increase their compliance costs as they must assess whether they come within the various definitions of each regulator. It is CCIWA's view that a broad and consistent definition of 'small business' is a critical factor to address in simplifying the tax regime for small businesses. Further it is recognised that arbitrary 'cut-off' points can act as a disincentive for business growth.

CCIWA recommends that the Board consider mechanisms to harmonise small business definitions that allow for an incremental phasing out of access to concessions as the size of a business increases.

[11] Under section 45A(2) of the *Corporations Act 2001* (Cth), a proprietary company is a small proprietary company if it satisfies two of the three criteria: annual revenue of less than $25 million; fewer than 50 employees at the end of the financial year; and consolidated gross assets of less than $12.5 million at the end of the financial year.

[12] Under part 328-110(1) of the *Income Tax Assessment Act 1997* (Cth), a small business entity is one that carried on business activity with aggregated turnover of less than $10 million in the last financial year.

[13] Under section 23 of the *Fair Work Act 2009* (Cth), a national system employer is a small business employer at a particular time if the employer employs fewer than 15 employees at that time.

Feedback from CCI's SME Members

"The small business eligibility criteria is a **significant deterrent to growth**."

"You need to have clarity for both business and consultants that represent businesses to obtain rebates. **We don't know where we stand because we can't get straight answers as to what it is the ATO or Austrade require** to enable a grant being offered."

Thresholds for Concessions are Unclear

In addition to differing definitions, there are a variety of thresholds in the tax system that are applicable to small businesses, such as the general thresholds for marginal personal taxation rates that are relevant to non-corporate small businesses, thresholds for eligibility for concessions relevant to both the level and timing of tax payments, and thresholds relevant for recordkeeping and reporting requirements. These thresholds are based on a range of measures including income, turnover, and dollar values of goods and services purchased. While some thresholds are subject to regular review and/or indexation, others are reviewed on an occasional basis, while others appear subject to infrequent review. Where thresholds for concessions aimed at reducing compliance costs are not adjusted regularly, compliance costs may increase. In designing tax concessions and broader tax policies, CCIWA encourages the Board to define a review period in the framework to ensure that thresholds remain relevant and do not create unintended consequences.

There are various thresholds that small businesses need to meet to be eligible for certain concessions. For instance, some concessions are available if the entity in question meets the definition of 'small business entity' (annual turnover threshold of $10 million); some if they meet the definition of 'CGT small business entity' (annual turnover threshold of $2 million); some if they meet the definition of 'base-rate entity' (annual turnover threshold of $25 million); and some if they meet expenditure requirements and turnover thresholds (such as those required to access the research and development tax incentive[14]). A reform which would be of significant benefit to small business – and taxpayers in general – would see concessions governed by one or two harmonised qualification criteria.

The increase in the annual turnover threshold for FBT concessions from $2 million to $10 million (effective from 1 April 2017) is positive news for businesses as it brings the concession threshold in line with the ATO's definition of 'small business'. This means that if a business is a small business entity for tax purposes, it is generally eligible for the work-related portable electronic device (FBT) exemption.

[14] To access the research and development (R&D) tax incentive, a business is required to spend $20,000 per annum on eligible R&D activities and the rate of the offset is determined by the size of business turnover.

There is also merit in exploring whether turnover is the best measure for determining concession eligibility.

Feedback from CCIWA's SME Members

"**Turnover is a very poor measure of business size and should not be used to determine eligibility for concessions**."

The Existing Threshold for PAYG Withholding Obligations Should be Increased

As an employer, a small business owner is legally required to withhold a portion of payments made to their employees or contractors (PAYG withholding) to pay on to the ATO at regular intervals.

Small businesses are required to report their PAYG withholding obligations on a monthly basis through the lodgement of an Instalment Activity Statement (IAS) where their annual withholding obligations are between $25,001 and $1 million in a financial year. An increase in these reporting thresholds would allow many small businesses to report on a quarterly, rather than monthly basis, thus relieving them from the monthly lodgement burden. In many cases, this would also align their PAYG withholding reporting with their GST reporting.

Feedback from CCIWA's SME Members

"Reduce the frequency of reporting and providing GST. Make tax payable on anticipated profit half-yearly."

Payroll Tax is a Barrier to Growth

Whilst the collection of payroll tax is not within the Commonwealth's jurisdiction nor the scope of the Board's Review, it is an important issue to be considered when assessing the interaction between small businesses and the tax regime. CCIWA's SME members have consistently identified payroll tax as a major disincentive for growth. As a matter of principle, CCIWA opposes any payroll tax schemes. However, it is understood that payroll tax remains a primary revenue source for all the States and Territories and is thus unlikely to be removed. This is an exceptionally pertinent issue for WA business.

Analysis by the Commonwealth Treasury[15] suggests that payroll tax in general has limited influence on business behaviour. However, the same analysis suggests that in States that have a relatively broad payroll tax scheme, such as WA and Victoria[16], a greater number of SMEs who would be liable to pay payroll tax are likely to alter their behaviour to minimise their exposure to payroll tax. The implications of this are twofold.

Firstly, this reinforces the assertion that SMEs have less capacity to absorb additional costs in their business.

Secondly, this suggests that the common thinking around payroll tax scheme best practice may need refining. The payroll tax regimes in Victoria, New South Wales, and Western Australia can often be considered 'good' models as they are relatively broad-based with low rates of taxation. However, it appears that these regimes have a greater impact on business behaviour when compared to other regimes. The notable exception to this is South Australia, where the Treasury Working Paper found no apparent evidence of business behavioural change that was explicitly motivated by a need to reduce payroll tax liability.

As shown in Table 1, South Australia has the lowest rate and most broadly-based payroll tax regime in the country, suggesting that payroll tax regimes need to be both a very broad base and extremely low rate to have minimal impact on business behaviours.

State	Payroll Tax Free Threshold (2017/2018FY)	Payroll Tax Rate (lowest bracket) (2017/2018FY)
Western Australia	$850,000/annum	5.5%
Victoria	$650,000/annum	4.85%
South Australia	$600,000/annum	2.5%
Queensland	$1.1 million/annum	4.75%
New South Wales	$750,000/annum	5.45%
Tasmania	$1.25 million/annum	6.1%

Table 1: Payroll Tax – Rates and Thresholds
Source: 2017-18 State Budgets

[15] Ralston, B (2018) *Does Payroll Tax Affect Firm Behaviour*, Treasury Working Paper.
[16] The payroll tax free thresholds for Western Australia and Victoria are $850,000 and $650,000 respectively.

South Australia has the second lowest payroll tax revenue per-employee in the country [Figure 4]. Current payroll tax settings put a handbrake on the WA economy and disincentives job creation. CCIWA strongly supports increasing the payroll tax threshold to make the State's tax regime more competitive and to stimulate employment in WA.

The payroll tax burden of WA SMEs is disproportionately high. WA businesses pay the highest amount of payroll tax per employee out of any State or Territory [Figure 4]. WA businesses with a payroll over $1.5 million also have the highest effective payroll tax rate [Figure 5][17].

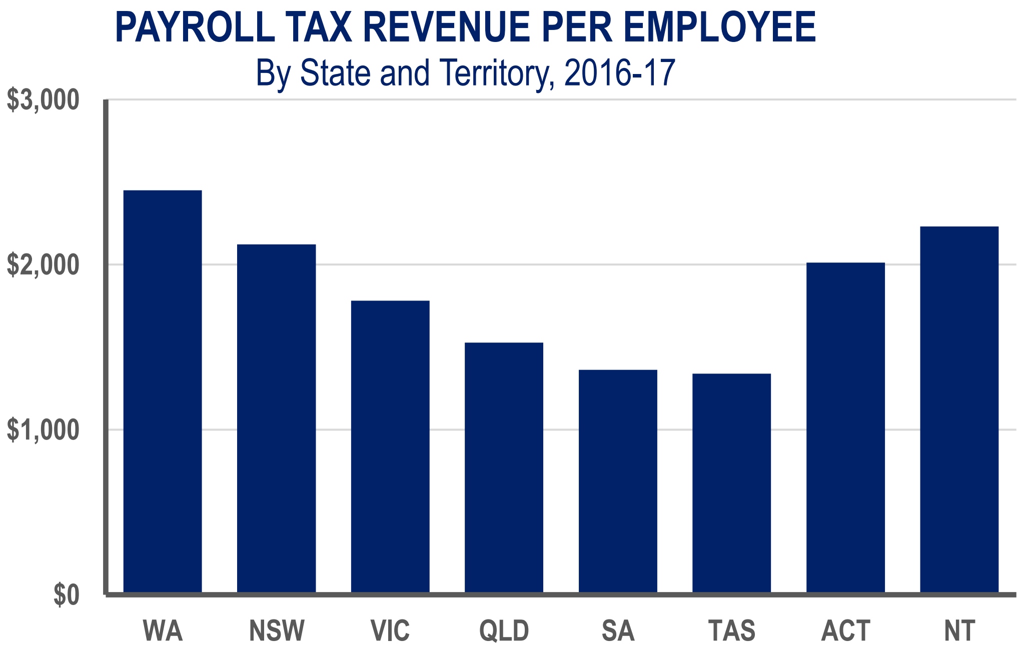

Figure 4: Payroll Tax Revenue per Employee by State
Source: 2017/18 State and Territory Budgets. Based on calculations by Chamber of Commerce and Industry of WA.

[17] A payroll of $1.5 million equates to about 15 employees, based on WA's average weekly earnings.

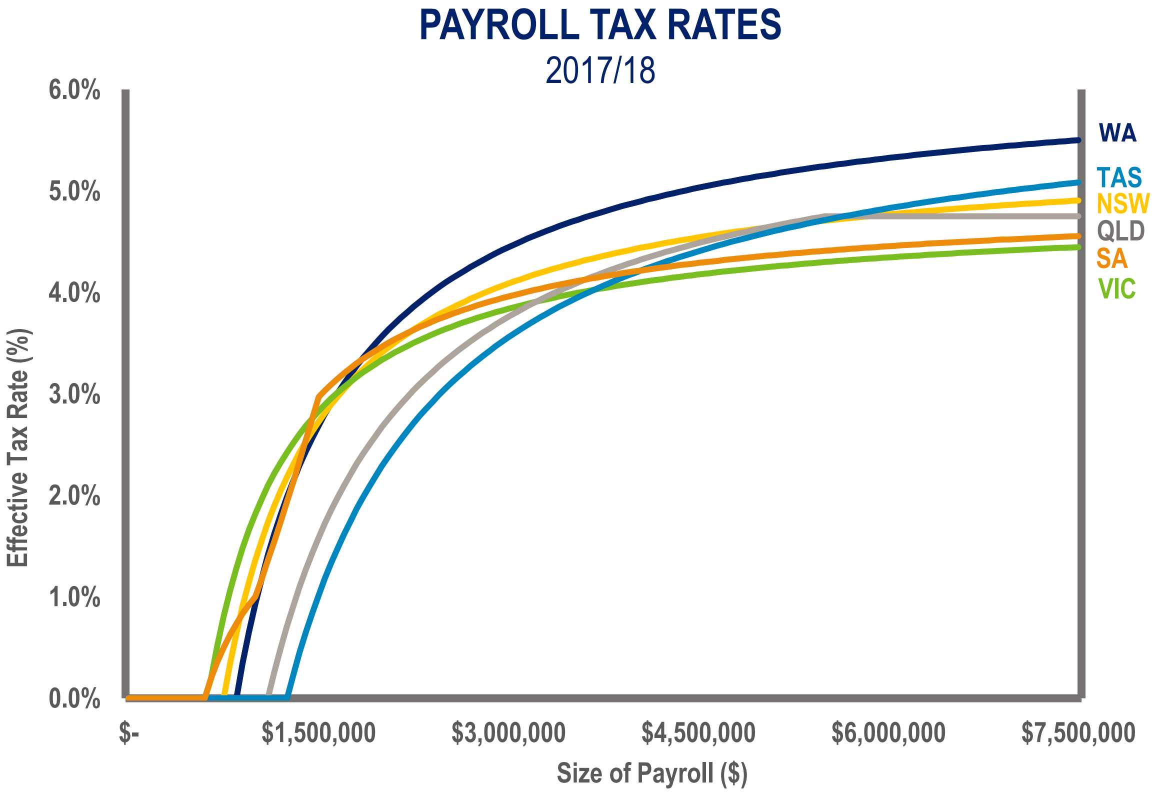

Figure 5: Payroll Tax Rate by Size of Payroll and State
Source: 2017/18 State Budgets.

To this end CCIWA encourages the Board to consider the impact that State-based payroll tax has on SMEs and explore ways to minimise the impact of payroll tax on SMEs. It is recommended that the Board consider developing a 'best practice' guide for small businesses-friendly payroll tax schemes.

Feedback from CCI's SME Members

"P**ayroll tax is a significant deterrent to growth**."

"Provide a concession for payroll tax. It is illogical for the States and Territories to tax us for employing more people. **It encourages small businesses to stay small and reduces the income tax that the ATO ought to receive**. This tax is abhorrent."

"For employing more people, we are rewarded by paying 5 per cent in payroll tax."

"Rather than reduction in company tax **we would rather have payroll tax removed completely**."

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