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Review into tax system impediments facing small business

The Board of Taxation

c/- The Treasury

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### RE: Review into tax system impediments facing small business

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the request for comments on the Board of Taxation's fast-track review into tax system impediments facing small business.

#### About ASFA

ASFA is a non-profit, non-politically aligned national organisation. We are the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate policy in the best long-term interest of fund members. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

#### Background to comments

The Ministers' press release announcing the review by the Board of Taxation (the "Board") refers to 'features in the tax system' and small businesses 'interaction with the tax system'.

It is noted that the Government wants small business owners to 'spend less time on paperwork and more precious time and resources on growing their business.' This review, which has as its focus making small business dealings with the Australian Taxation office simpler, is viewed by ASFA as but one part of a more comprehensive process of easing small business overall compliance costs.

The terms of reference state:

- 'The Board should not feel constrained to use any specific definition of small business.' and
- 'To facilitate the production of this fast-track review ..... the report should utilise and build upon the conclusions of the Board's scoping study of small business tax compliance costs, which was completed in December 2007'.

For the December 2007 *Scoping study of small business tax compliance costs* ("the December 2007 report") the Board was asked to work closely with small businesses to identify and analyse the main costs they face in complying with taxes administered by the Australian Taxation Office (ATO). The December 2007 report was informed by the 2005 *Board of Taxation – Small Business Tax Compliance Costs* report to the Board by the Australian School of Taxation from the University of New South Wales ("the Atax report"). The Atax report was a qualitative study to identify and describe small business compliance costs (with a particular emphasis on tax compliance costs).

The Atax study, which adopted a grounded theory approach, conducted in depth interviews with 30 small business owners. Examined were the characteristics of the businesses, book keeping practices, Business Activity Statement (BAS) practices, income tax return preparation, staff-related issues, compliance with other regulations, compliance costs, incidental costs and benefits of compliance activities.

In both the Atax study and the Board's December 2007 report to the Treasurer, concerns with the compliance costs associated with superannuation, together with other employment compliance costs such as employment declarations, workers' compensation and occupational health and safety were categorised as employment compliance costs and non-tax compliance costs.

In more recent times, compliance costs associated with small businesses superannuation guarantee obligations have been a topic of interest to the acting Assistant Treasurer.

### **ASFA comments on tax system impediments facing small business**

Although superannuation-associated compliance costs strictly are not captured by the terms of reference, being identified by the Board of Taxation as non-tax compliance costs, ASFA thinks it is appropriate and timely that the Board be updated on the superannuation matters raised in both the 2005 Atax and the December 2007 reports.

### **THE 2007 BOARD OF TAXATION REPORT TO THE TREASURER**

Chapter 10 of the December 2007 report deals with key non-tax compliance concerns. It notes the strong consensus among small businesses that the employment of staff imposes significant regulatory compliance costs due to 'regulatory obligations associated with labour issues such as employment declarations, workers' compensation, superannuation and occupational health and safety'.

Superannuation is given special mention, with the following aspects noted in the report as causing compliance issues for small businesses:

- Businesses that managed their own superannuation fund found the related compliance requirements difficult. Tax agents confirmed that there were significant complexities involved in assisting their small business clients with self managed superannuation funds (SMSFs). Nevertheless, the numbers of SMSFs is growing rapidly.
- Uncertainty of the classification between an employee and a contractor for superannuation guarantee purposes (as well as tax, WorkCover and workers' compensation) was a driver of compliance costs and a deterrent to employing staff. In some circumstances, contractors may be within the Superannuation Guarantee ("SG") requirements.
- Employees having a choice of superannuation fund caused additional compliance costs for employers, to the point that some businesses charge employees a fee if they exercise 'choice' (even if that is not legal).
- The requirements for businesses to pay small amounts to superannuation funds (in the case of casual employees) and having to make superannuation payments within a specific timeframe caused additional compliance costs (time and stress). Some businesses had difficulty in having small payments accepted by some superannuation funds, and others faced additional compliance costs when their casual employees earned around the \$450 per month threshold. This is particularly an issue in the restaurant and hospitality sector.

In relation to each of these points ASFA makes the following comments:

#### ***On SMSFs***

As an employee generally cannot be a member of their employer's SMSF, unless the employer is prepared to have the employee be a director of the trustee company, the SMSF compliance issues relate to the decision of the employer to have an SMSF as their personal superannuation vehicle. That is, the compliance issues are not related either to being a small business or to employing staff. Rather, it is an avoidable compliance issue/cost that is directly related to the decision by the business owner to establish an SMSF as their personal superannuation vehicle – not to do with their running a small business.

#### ***On uncertainty of classification***

It has long been established that the expanded definition of 'employee' in the *Superannuation Guarantee (Administration) Act 1992* ("SGA Act") is a source of confusion to many employers. Many relationships that normally would not be considered to be an employer/employee relationship are captured under the SGA Act. As one of its tax regulation recommendations, the Banks Taskforce<sup>1</sup> recommended (Recommendation 5.44) the alignment of the definitions of 'employee' and 'contractor' across tax

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<sup>1</sup> The Banks Taskforce was established in October 2005 'to identify actions to address areas of Australian Government regulation that are unnecessarily burdensome, complex, redundant, or duplicate regulations in other jurisdictions'

legislation. The recommendation was rejected<sup>2</sup> by the then government on the grounds that it would “reduce Superannuation Guarantee coverage and possibly compliance”.

Thus the broader definition of employee could be categorised as an anti-avoidance measure. That is, it is consistent with the policy that the Superannuation Guarantee should have broad coverage and business should not be able to gain a commercial advantage based on how labour is engaged.

### ***On choice of funds compliance costs***

The choice-of-fund compliance burden has two broad aspects: the paperwork associated with offering choice, and the additional cost associated with paying contributions to an employee's chosen fund. It is a policy decision of Government that employees be given, as far as is practicable, the right to choose the fund into which their Superannuation Guarantee entitlements are paid. It is presumed that, in making this decision, the Government considered the costs to employers of the policy.

With respect to the paperwork associated with offering choice we note that this matter was being addressed by the Australian Taxation Office (the “ATO”) under its proposed SuperStream – new employee engagement process initiative. The goal was to integrate the processes for tax file number declaration and choice of superannuation fund and offer an on-line completion process through the ATO's Individuals Portal. Funded from the SuperStream component of the Superannuation Supervisory levy collected from superannuation funds regulated by the Australian Prudential Regulation Authority, the new process would have efficiently delivered better information for employers and employees. In December 2013 the then Assistant Treasurer, Senator the Hon Arthur Sinodinos AO, announced that following the outcome of consultations, including with the Board, over the backlog of 92 announced but unlegislated tax and superannuation measures this initiative would not proceed<sup>3</sup>. With respect to contributions, to ameliorate the compliance cost of paying to multiple funds, the government has established a free contribution payment service for employers with fewer than 20 employees. This service is now provided by the ATO, having previously been administered by the Department of Human Services. Under this service, an employer registers with the ATO and provides details of the employees for whom it will make superannuation contributions and the fund to which each employee's contributions are to be paid. Having established the records, the employer then, at a time of their choosing, provides details of the individual contributions and transfers the total amount to the ATO. The ATO then distributes the contributions to the nominated fund(s). Small business users of this facility rate it extremely highly.

As noted in both the 2005 Atax and the December 2007 reports, many small employers engage an agent to undertake the superannuation contribution task, preferring to trade off the small cost to gain additional time to apply to the business or other activities.

Currently, contribution processing arrangements are being fundamentally changed. The phased introduction from 1 July 2014 of mandated data standards under the SuperStream program of changes will enable superannuation contribution payment solutions to be delivered at low cost as part of business software solutions. Some small employers will start to see improvements in business software solutions from late 2014.

### ***The requirement to pay small amounts***

With a monthly payroll threshold of \$450, the smallest superannuation guarantee obligation is \$41.62. When the superannuation guarantee commenced in 1993, the smallest payment was \$13.50. Whilst the non-acceptance of small amounts was an issue with some funds in the past, this is no longer an issue where the choice-of-fund rules are properly applied as the choice form requires acknowledgement from the trustee that they will accept all employer contributions with respect to the employee/member. ASFA considers that the issue is not so much with the size of the payment, but rather in determining whether an employee's remuneration is under or over the threshold in any given month. This is a particular problem in sectors of the economy with a highly casualised workforce. With the introduction of the data standards and a requirement to pay all contributions electronically it is perhaps appropriate, once the new arrangements have been bedded down, to re-consider the need for a minimum SG payroll threshold: the last remaining challenge for these employers.

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<sup>2</sup> Of 178 recommendations only 20 were not accepted in full or part by the government.

<sup>3</sup> This is item number 72 in the list of unenacted measures that would not proceed.

## THE 2005 ATAX REPORT

The Atax report, which was a scoping report into the sources of compliance cost for small business, was based on interviews with 30 small business owners. As such there are some limitations, due to sample size, sample selection and the changing financial landscape in the intervening years, to the extent to which the findings can be applied to the broader population. The report includes a table (Table A-4: Staff related issues) which summarises the business owner's comments on staff related issues. An analysis of the table reveals that of 30 interviews, superannuation rated a mention in 16. Of those 16:

- 10 merely mention superannuation in passing with no comment either favourable or unfavourable.
- 2 have SMSFs and complain about the complexity of administration
- 1 imposes an administration charge for paying to a choice fund (ASFA note: this is effectively prohibited under section 32CA of the SGA Act)
- 1 complains of being required to be a registered employer to pay to a choice fund (ASFA note: this is prohibited by regulation 7.04A of the *Superannuation Industry (Supervision) Regulations 1994*. In such cases the employee's choice of fund would also be invalid under section 32G of the *SGA Act* and should be rejected by the employer).
- 1 states that super is a constraint on hiring, and
- 1 complains that dealing with 10 funds is a nuisance.

In summary, of the 30 small business owners interviewed, there is a lack of understanding of the correct operation of the SG law (3 business owners), concerns with the complexity of running your own superannuation fund (2 business owners, noting this is not a superannuation guarantee related problem) and concern over paying to choice funds (2 business owners).

ASFA considers that these comments are broadly indicative of the small business/superannuation relationship. However, as set out above, the substantive complaint of the complexity of dealing with multiple funds is currently being addressed through the ATO Clearing House and SuperStream and will be resolved over time.

Further to this, we note there have been suggestions that businesses should be permitted to pay superannuation contributions to the ATO as part of their PAYG obligations, with the ATO being tasked with distributing the money and the contribution details to the employee's fund. ASFA considers that such a process would undermine the SuperStream initiatives currently being implemented, designed to address this specific problem and on which there has been considerable expenditure, including the SuperStream levy. We also note that one of the key aims of the process is to reduce small business costs and simplify the process. The ATO Clearing House and the current SuperStream reforms are designed to achieve the same aims. ASFA is concerned that the proposal will increase overall complexity, increase overall system costs, introduce economic inefficiencies and adversely impact retiree outcomes through the delaying of payment of contributions to align with the PAYG cycle. With this in mind, ASFA strongly urges that, before other options are considered, the current SuperStream contributions initiatives should be implemented and given the opportunity to become 'business as usual'. Introducing other processes at this stage would result in increased uncertainty, processing complexity and business cost for employers and others.

That said, an area where there is concern, and which should be addressed is the apparent lack of information for employers as to what **their** rights are with respect to offering choice of fund to employees. Whilst adequate advice exists as to what employers must do, there appears to be limited clear advice to employers as to the circumstances under which they may reject an employee's particular choice of fund. We suspect that the situation of knowing what you must do, but not what you can do or what you do not have to do, will be paralleled in many other parts of small business operations.

## Conclusion

ASFA supports the generally held view that compliance costs have a greater impact on small businesses than on larger businesses. As the December 2007 report found, "size, turnover and business structure influence the compliance costs of small businesses and they can vary over the life cycle of the business. Choices that businesses make in these areas, such as incorporating and employing staff, can impact on compliance costs. Small businesses need to be aware of the compliance cost implications of the choices that

they make. In addition, the skills, attitude, efficiency and confidence of the small business owner influence their perceptions of compliance costs.”

The report also found that it ‘is also important for small businesses that are not currently using modern technology to embrace recent technological advances, particularly computerisation. Technological systems should be developed that can be easily accessed by all businesses, regardless of size, and which ultimately enable all small businesses to use software and portal interface products that service their accounting and taxation obligations at the same time. A positive consequence of this should be a compliance requirement that is only minimally higher than that necessary for regular business operations.’

We suspect that the use of modern technology has improved, but is still an issue.

The introduction of mandated data standards for superannuation contributions and the requirement for all contributions to be made electronically may just be the impetus that small businesses need to modernise. As the Ministers say in their press release ‘we want small business owners to spend less time on paperwork and more precious time and resources on growing their business.’ ASFA considers that this can be achieved through the adoption of technological solutions to business management processes. To this end ASFA recommends that the government, in addition to simplifying small businesses interactions with the ATO, encourages and supports the adoption by small business of integrated business management software.

The December 2007 report also identified that the ‘skills, attitudes, efficiency and confidence of the small business proprietor are significant determinants of whether they are likely to be concerned about tax compliance obligations.’ This highlights the need for small business owners not only to be good at what they do, but also to possess the requisite business skills to enable them to succeed as a business. To achieve the necessary outcome, ASFA recommends that the Government actively support the development of business management resources aimed at developing the business management skills of those engaged in small business.

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I trust that the information contained in this submission is of value.

If you have any queries or comments regarding the contents of our submission, please contact ASFA’s Principal Policy Adviser, Robert Hodge, on (02) 8079 0806 or by email [rhodge@superannuation.asn.au](mailto:rhodge@superannuation.asn.au).

Yours sincerely



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