

Scoping study of small business tax compliance costs

A report to the Treasurer

December 2007

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FOREWORD

There is no doubt that compliance costs have a proportionally greater impact on small businesses than on larger businesses and this compliance burden appears to have been growing over time. Reducing small business compliance costs is vital to the Australian economy, with the small business sector being a key contributor to growth and employment.

The diverse nature of the small business sector means that there are a range of factors that influence both the nature and level of tax compliance costs. Each small business has a different tax compliance experience.

Equally, there is no single person or organisation responsible for influencing compliance costs. The actions of government (at all three levels), administrators, small businesses, tax agents, the tax profession more broadly and the general community all impact on the compliance costs faced by small business. This makes the identification of measures to reduce compliance costs difficult. There are no simple, ready-made solutions that will cut through the compliance load. Compliance costs must be addressed on a range of fronts over time and measures to reduce compliance costs need to involve all these parties.

To assist in this process, in this report the Board has sought to identify the factors that influence compliance costs and draw out some guidance on the kinds of issues that should be considered in reducing compliance costs for small business, as well as areas where small businesses consider there might be opportunities to reduce compliance costs further. In doing so, the Board acknowledges that progress has been made in recent years in addressing the compliance costs of small business through review and reform of legislation and administration.

What is clear to the Board is that *changes* to the tax system (the changes themselves, the pace of change and the timing of change) can increase compliance costs as both small businesses and their tax agents seek to understand new taxing arrangements. However, change is also necessary to address concerns about compliance costs. Careful management of the change process is the key to minimising the compliance costs associated with change.

In particular, when changes are proposed to the tax system affecting small business, all stakeholders should be mindful of the likely effect of change on compliance costs. In addition, while each individual change might not necessarily increase compliance costs, the cumulative impact of a range of changes over time may nevertheless have a considerable impact on small business compliance obligations. Ad-hoc responses to

issues as they arise may also not be as effective as more considered systemic changes that seek to address the causes of problems, rather than the symptoms.

Improved consultation with small business in the development of changes to the tax system and the education of small businesses about tax compliance obligations will also assist in reducing compliance costs associated with change. There are roles for the ATO, the tax profession and other private sector organisations in providing these education and support services. Small businesses also have a responsibility to seek out the services that best meet their needs and to devote the time needed to meet their compliance obligations successfully.

While the adoption of modern technology may increase business costs in the short term, the use of computerised recording and reporting systems and other technology provides opportunities for small businesses to run their core business more effectively and reduce ongoing compliance costs. There is a role for government in facilitating the use of technology and for industry in designing software packages that are well aligned with tax and business reporting requirements.

The Board would like to thank all of those who have assisted in preparing this report, particularly those small businesses and tax agents who gave freely of their time to improve its understanding of the factors influencing compliance costs. Treasury, the Tax Office and the Office of Small Business also provided invaluable advice to the Board.

The scoping study has been a challenging project for the Board because, while acknowledging the seriousness of compliance costs for small business, it was unable to point to specific measures that provide a panacea to the problem. Rather, as noted, an awareness by all parties of the compliance cost impacts on the small business tax system, and careful management of change, will over time result in reductions in the compliance obligations of small businesses.

R F E Warburton AO
Chairman, Board of Taxation

CHAPTER 1: EXECUTIVE SUMMARY

INTRODUCTION AND BACKGROUND

1.1 This report considers the regulatory compliance costs faced by small business in Australia, with a particular emphasis on tax compliance costs. It is a qualitative, rather than quantitative, study, based on discussions with small business owners, tax agents, industry representatives and government agencies, and an examination of government and academic research. **Chapter 2** describes how the study was conducted.

1.2 There is general acknowledgement that compliance costs have a greater impact on small businesses than on larger businesses and that this compliance burden has grown over time. Governments, both in Australia and internationally, have introduced a range of initiatives to try to reduce these costs.

1.3 Most recently in Australia the Banks taskforce made a range of recommendations addressed at reducing compliance costs associated with unnecessarily burdensome, complex, redundant or duplicative regulation. Twenty of these recommendations related to reducing tax compliance obligations. In addition, a range of other initiatives were undertaken by the previous Government and the ATO to reduce compliance costs. These are outlined in greater detail in **Chapter 3**. As a result, this report considers tax compliance costs in an environment of ongoing significant change to the tax system for small business. Many of the areas of concern raised with the Board either have been, or are being, addressed.

1.4 As a result the Board has taken an approach of identifying the factors that influence compliance costs, and drawing out of those factors some guidance on the kinds of issues that should be considered in reducing compliance costs for small business, as well as some areas where there might be opportunities for further significant reductions in compliance costs.

1.5 The vast majority of Australian businesses are small businesses. There are around 1.84 million small businesses in Australia with turnover of less than \$2 million, representing around 93 per cent of all businesses. Those small businesses are very important to the Australian economy, providing around 39 per cent of Australia's industry value added and employing almost half of the non-agricultural workforce. **Chapter 4** outlines the nature of the small business sector.

1.6 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 need to acknowledge that running a business necessarily involves some obligations beyond those of an employee. Some of these are essential to running the business, such as accounting and record keeping requirements, and need to be clearly distinguished from regulatory compliance costs. **Chapter 5** discusses the nature of compliance costs.

DRIVERS OF TAX COMPLIANCE COSTS

1.7 Small businesses are extremely diverse and their compliance costs are influenced by a range of factors. As a result, the experience of both tax and non-tax compliance costs can vary significantly from business to business. For some businesses, tax compliance costs will dominate, but for others, non-tax compliance costs will be more significant. **Chapter 6** outlines some of the features of small businesses that can influence compliance costs.

1.8 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.

1.9 Small businesses operate across all industry sectors, with many small businesses in the property, business services, construction, retail trade and agricultural sectors. Industry sector can influence both the level of compliance costs and whether tax or non-tax compliance costs are more significant. Businesses that operate in the construction, restaurant and catering, agricultural and mining industries, in particular, appear to experience significant non-tax regulatory compliance costs. Businesses that operate across state and national boundaries are also likely to have higher compliance costs. Streamlining and achieving greater consistency across Commonwealth, state and territory jurisdictions will assist in reducing regulatory burdens.

MANAGING TAX COMPLIANCE COSTS

1.10 Both the level and nature of compliance costs borne by small business can be affected by how they choose to deal with their compliance obligations. Small business may meet all their compliance obligations themselves, seek assistance from family and friends, or pay others to meet those obligations.

1.11 A significant number of small businesses outsource their tax compliance obligations, particularly to tax agents and bookkeepers. In doing so, they can reduce

the stress of compliance and free up their time to focus on running the business, although this will increase their monetary compliance costs. Key factors determining whether businesses outsource their tax compliance obligations include the size and complexity of the business, the cash flow, the proprietor's understanding of their record keeping and reporting obligations, and the prioritisation of their time. **Chapter 7** outlines the role of tax agents and bookkeepers in meeting tax compliance obligations.

1.12 In recent years there appears to have been an increasing demand for the services of tax agents. While the number of small businesses using tax agents has remained fairly stable, the nature of the services sought from tax agents may have expanded. This increased demand, coupled with the steady flow of new and amending legislation and explanatory material and a tight labour market, is placing significant pressure on the tax agent industry. The bookkeeping industry has also grown significantly in recent years. While this has assisted in reducing the pressure on tax agents, it has raised issues about the quality of the services provided by bookkeepers.

1.13 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.

ADDRESSING TAX COMPLIANCE COSTS

1.14 As there are a range of factors that affect the compliance costs of small businesses, there are no simple, ready-made solutions that will easily alleviate their tax compliance concerns. Reductions in compliance costs are likely to be gained gradually over time through concerted effort by all stakeholders in the small business tax system. **Chapter 8** identifies some key broad issues which, if considered when making changes to the small business tax system, could assist in reducing compliance costs going forward.

1.15 There are a range of policy choices and trade-offs that need to be made in designing changes to the small business tax system that can have a significant impact on compliance costs. All stakeholders need to be aware of these trade-offs when considering the design of changes.

1.16 In particular, finding a balance between certainty and simplicity is a key challenge for all participants in the tax system. Taxpayers' desire for certainty from the tax system is being met by the issue of a range of guidance material, which can increase

tax system complexity. It also influences the level of detail that is included in the legislation itself.

1.17 In addition, the provision of a range of choices, concessions and thresholds for small businesses in the tax system adds to complexity and encourages small businesses to seek professional advice, which increases their monetary compliance costs. This can be exacerbated where the tax system is used to achieve social and other broader policy objectives.

1.18 As has been noted above, this study has been unable to identify a single, precise aspect of the tax system that is driving small business tax compliance costs. Rather, the ongoing accumulation of regulation at all levels of government appears to be the problem. However, **Chapter 9** identifies those parts of the tax system that were identified by small businesses and tax agents in our consultations as having particularly intensive compliance requirements. There may be opportunities to reduce small business compliance costs in these areas.

NON-TAX COMPLIANCE COSTS

1.19 There does not appear to be strong community consensus on how significant tax compliance costs are compared with other broader compliance issues for small businesses. This may be in part because the relative importance of tax and non-tax compliance costs varies from business to business. **Chapter 10** outlines some of the key non-tax compliance issues that were identified by small businesses as part of this study.

FINDINGS

Finding 1

The vast majority of Australian businesses are small businesses. Around 93 per cent of all Australian businesses by number have turnover of less than \$2 million per year.

Finding 2

Small businesses are very important to the Australian economy. They produce around 39 per cent of Australia's industry value added and employ almost half the non-agricultural workforce. Most are engaged in the property and business services, agriculture, construction and retail sectors.

Finding 3

While not-for-profit organisations are not generally established for business purposes, in some respects they may experience similar compliance issues to small businesses.

Finding 4

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, the smaller the business.

Finding 5

Governments, both in Australia and internationally, have recognised that small businesses have proportionately higher tax compliance costs and have introduced initiatives to try to reduce these costs.

Finding 6

Compliance costs can be both financial and non-financial. In some cases, non-financial compliance costs, such as stress and time lost, can be just as significant, if not more so, than the financial compliance costs. Many small businesses choose to replace stress and time costs with financial costs by paying tax agents and bookkeepers to assist in meeting their tax compliance obligations.

Finding 7

Small businesses may become confused about what tax compliance costs are. They do not always distinguish between tax compliance costs and either the amount of tax they have to pay or the general accounting and record keeping costs that are an essential part of running an effective business.

Finding 8

Tax compliance may provide benefits to businesses by imposing a discipline that allows them to better monitor and understand their business dealings and cash flow. Tax agents are often more likely to recognise these benefits than small businesses themselves.

Finding 9

The small business sector is extremely diverse and the compliance costs of small businesses are influenced by a range of factors. As a result, the experience of both tax and non-tax compliance costs can vary significantly from business to business. For some businesses, tax compliance costs will dominate, but for others, non-tax compliance costs will be more significant.

Finding 10

Size, turnover and business structure influence the compliance costs of small businesses. New businesses tend to start with low turnover and simple business structures, and generally have lower compliance costs. As the business becomes more successful over time and turnover grows, owners tend to move to more complex

business structures, for example companies and trusts, to minimise risk and tax. This can increase both tax and non-tax compliance costs.

Finding 11

Small businesses may not always be fully aware of the tax and non-tax compliance cost implications of establishing their own business and changing from simple to more complex business structures such as a company and/or trust.

Finding 12

Employment of staff imposes significant regulatory compliance costs, many of which are not tax related.

Some business operators choose not to grow beyond a certain size so that they can avoid additional risk, complexity and administrative burdens.

Finding 13

Industry sector can influence both the level of compliance costs and whether tax or non-tax compliance costs are more significant. Businesses that operate in the construction, restaurant and catering, agricultural and mining industries, in particular, appear to experience significant non-tax regulatory compliance costs.

Finding 14

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.

Finding 15

Businesses with computerised recording and reporting systems tend to manage their compliance costs better.

Finding 16

A significant number of small businesses outsource their tax compliance obligations, particularly to tax agents and bookkeepers. Key factors determining whether businesses outsource their tax compliance obligations include the size and complexity of the business, the cash flow, the proprietor's understanding of their record keeping and reporting obligations, and the prioritisation of their time.

Finding 17

Some progress has been made in standardising the definition of 'small business' in tax law, but different definitions are still used in other parts of the law, making it difficult to define clearly the boundaries of the small business sector. There would be merit in exploring the broader application of a standard definition across all legislation.

Finding 18

Inconsistent definitions and thresholds for concepts such as ‘employee’ and ‘salary and wages’ cause complexity in the law and uncertainty for small businesses, potentially adding to their compliance costs.

Finding 19

Businesses that have to comply with regulations imposed by several jurisdictions because they operate across state and territory borders experience higher regulatory compliance costs than those that operate within one State or Territory. Trading across national borders is likely to increase compliance costs further, with nearly half of all Australian exporters being small businesses.

Finding 20

Use of the tax system to achieve social and other broader policy objectives can increase the complexity and pace of change of the law. This can influence perceptions of compliance costs and may in some cases increase actual compliance costs.

Finding 21

The provision of a range of choices, concessions and thresholds for small business in the tax system adds to complexity and encourages small businesses to seek professional advice, which increases their financial compliance costs.

Finding 22

Achieving both certainty and simplicity is a key challenge for all participants in the tax system. While taxpayers’ desire for certainty from the tax system is being met by the ATO offering to tax agents a range of public and private rulings, determinations, practice statements and other supporting materials, these can increase the overall complexity of the system.

Finding 23

Change to the tax system can increase compliance costs as both taxpayers and tax agents seek to understand new arrangements. However, change is also necessary to address concerns about compliance costs. Mandatory compliance cost assessments will assist in determining whether particular changes will increase or reduce compliance costs.

While individual changes may be justified, they need to be considered in the context of other changes that are being made. The cumulative impact of all changes on compliance costs also needs to be considered.

Finding 24

The complexity of the tax system and recruitment difficulties are placing significant pressure on the tax agent industry.

Finding 25

Consultation with small business is important to ensure that the design of tax policy, legislation, administrative systems and supporting materials suits the needs of small business.

Finding 26

Education of taxpayers and tax agents can assist in reducing tax compliance costs. There are roles for the ATO, the tax profession and other private sector organisations in providing education, and small businesses themselves need to seek out those services that best meet their needs.

Finding 27

There is no single, precise aspect of the tax system that appears to be driving the tax compliance concerns perceived by small businesses. Rather, changes to and the accumulation of regulation at all levels of government appear to be the problem. Consequently, there is no simple 'quick fix', and improvements are only likely to be achieved through concerted effort by governments across jurisdictions.

Finding 28

While concerns about completing Business Activity Statements appear to be gradually decreasing over time as businesses become familiar with the requirements, the BAS is still regarded as the most annoying and time consuming tax compliance requirement for small businesses. The degree of the concern varies from business to business. Ongoing education of small businesses about BAS requirements is likely to assist in easing the compliance burden.

Finding 29

While changes have been made recently to improve the operation of the small business capital gains tax concessions, the complexities of capital gains tax legislation still make it difficult for small businesses to comply easily.

Finding 30

While very few small businesses pay fringe benefits tax, some small businesses undertake considerable compliance activities in order to avoid being included in the FBT system.

Finding 31

Many small businesses are experiencing significant tax compliance costs in attempting to manage intergenerational transfer of business assets. The lack of a comprehensive regime across all levels of government to deal with succession planning issues appears to contribute to this cost.

CHAPTER 2: THE REVIEW PROCESS

BACKGROUND TO THE REVIEW

2.1 On 4 November 2005 the previous Government announced that it had asked the Board of Taxation to undertake a scoping study of tax compliance costs facing the small business sector, and provide a final report to the Treasurer during the second half of 2006.¹

2.2 The Board was asked to take into account:

- the purpose and object of the law;
- the relationship between taxpayer compliance costs and government administration costs;
- costs incurred by business for non-tax reasons and any additional costs incurred by businesses or their advisors for tax reasons (tax compliance costs);
- transitional costs and ongoing tax compliance costs;
- taxpayer circumstances and commercial practices;
- other legislation; and
- any other matters the Board considered materially impact on small business tax compliance costs.

2.3 In addition, in response to recommendation 5.48 of the Banks Report², the previous Government referred the following issues to the Board for consideration as part of the scoping study:

- the Simplified Tax System;
- trust loss provisions and family trust elections;

1 The reference to the Board was announced in the then Treasurer's press release No 2005/095 – see Appendix 1.

2 *Rethinking Regulation* is the Report of the Taskforce on Reducing Regulatory Burdens on Business, also known as the Banks report.

- possible benefits of including additional information on activity statements to assist users;
- ways of reducing the number of PAYG withholding tables; and
- developing a systematic approach to adjusting thresholds in the tax law.

2.4 The Board has taken the view that it is beyond the scope of this study to consider rates of taxation and the overall amount of tax paid by small business. The Board has, therefore, limited its consideration to compliance costs.

APPROACH TO THE REVIEW

2.5 As this is a scoping study, the Board has made findings rather than recommendations. Those findings seek to identify a range of factors that if considered by all stakeholders going forward could assist in reducing compliance costs for small businesses and their tax agents. In particular the findings identify:

- features of small businesses and their operating environment that are relevant to compliance costs;
- other factors that both government and other stakeholders need to be mindful of in considering changes to small business taxation arrangements; and
- some specific areas of the taxation system where there could be opportunities for reducing compliance costs.

2.6 A key threshold issue for the Board was whether it should conduct a quantitative or qualitative study of small business tax compliance costs, or a combination of both. In making this assessment, the Board was mindful of the fact that there have been few quantitative studies of tax compliance costs in Australia, with the study by the Australian Taxation Studies Program for the ATO in 1997 being the most recent in-depth analysis.³ While there is some quantitative work internationally (and in New Zealand in particular), significantly more qualitative research has been undertaken.

2.7 The Board noted that quantitative studies have tended to be limited by difficulties in reliably measuring compliance costs. As the Board does not wish to enter a debate on issues of measurement, it has adopted a qualitative, rather than quantitative, approach to this study. The Board has gathered evidence for the study from a number of sources, including interviews and focus group discussions with small businesses and their tax agents, submissions from interested stakeholders, and

3 *A Report into the Incremental Costs of Taxpayer Compliance*, Evans C, Ritchie K, Tran-Nam B, Walpole M, AGPS, Canberra, January 1997.

other studies and research. It has been an iterative process of development of thoughts and ideas, testing them and then refining them further.

ATAX CONSULTANCY

2.8 Following a tender process, the Australian School of Taxation from the University of New South Wales (Atax) was appointed as consultant to undertake a qualitative study to identify and describe small business compliance costs (with a particular emphasis on tax compliance costs) and provide a report to the Board.

2.9 In conducting its study, Atax used a grounded theory approach.⁴ Atax identified 30 small business owners using convenience sampling⁵ and conducted in-depth interviews on the characteristics of their business, 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. Three accountants were also asked similar questions about the general experiences of their clients.

2.10 Atax's report to the Board outlined a set of theories about the nature of small business compliance costs and provided material that assisted in the identification of the regulatory requirements that imposed the most significant compliance burden on small businesses. These findings were tested and further developed by the Board through subsequent consultation. Reference to the Atax study will be made throughout this report, and a copy of the Atax report is located at the Board of Taxation website.⁶

CONSULTATION

Submissions

2.11 The Board sought submissions from the public on the issues identified in the terms of reference and received nine written responses. In addition, the Board indicated that issues raised in submissions to the Banks inquiry that were relevant to the scoping study would be considered. Appendix 3 list the bodies that made submissions directly to the Board as well as the submissions to the Banks inquiry that were considered.

4 Grounded theory involves generating theories based on the data collected.

5 Convenience sampling involves using a sample that can be accessed easily and conveniently.

6 The Atax report will be placed on the Board's website at the same time as this report.

Meetings with stakeholders

2.12 Consultation meetings were held in early 2006 to help identify the scope of the project and focus group discussions were held in September 2006, October 2006 and April 2007 to test the findings of the Atax report. These meetings involved participants from a range of small businesses, software developers and tax practitioners from across Australia.

2.13 Further consultation on a draft of the report took place in June 2007 with members of the ATO's Small Business Advisory Group and the Tax Commissioner's Small Business Consultative Group. These bodies comprise representatives of the small business community and peak bodies which represent small businesses. One additional submission was received through this process (see Appendix 3).

2.14 A list of consultation meetings is included at Appendix 4.

2.15 In addition, the Board sought information and comments from the Treasury, the ATO and the Office of Small Business.

LITERATURE REVIEW

2.16 A review of recent research undertaken on the nature of tax and other compliance costs was undertaken by the Board of Taxation Secretariat to provide contextual background. The review covered both Australian and overseas research published from 1996 to 2006. A list of documents reviewed and a summary of the research is at Appendix 5. The review provided a foundation for understanding the nature of compliance costs and international work on their measurement and extent.

2.17 The main themes identified in the literature were:

- compliance costs are regressive, meaning that they are proportionately higher for small businesses than for larger businesses;
- governments internationally have attempted to address small business compliance costs;
- compliance costs are higher for newer businesses; and

- the main causes of compliance costs are:
 - the sheer volume, complexity and pace of change of legislation;
 - the increasing complexity involved in operating a business;
 - the existence of small business concessions and other incentives which increase complexity;
 - while underlying policy objectives are sound, poor regulatory design and lack of robust consultation processes can result in unnecessarily complex law; and
 - regulatory overlaps and inconsistencies between jurisdictions.

CHAPTER 3: RECENT GOVERNMENT SMALL BUSINESS TAX INITIATIVES

BACKGROUND

3.1 Research into the level and incidence of compliance costs has increased in recent decades in response to growing criticism of governments worldwide for expanding regulatory compliance burdens on business. As the Banks report noted:

Like many other developed countries, Australia has undergone a relatively rapid rise in regulation over the past couple of decades, in response to a succession of social, environmental, and economic needs and pressures ... (B)usiness is justified in protesting at the compliance and other burdens that this regulatory inflation has entailed.

3.2 Governments worldwide have broadly acknowledged that small businesses have proportionately higher tax compliance costs than larger businesses and have introduced a range of initiatives to try to reduce these costs. These initiatives have taken a number of different forms. Some offer concessional arrangements for small business, partly to acknowledge the disproportionate burden of compliance costs for small business. Others have sought to simplify requirements either generally or specifically for small business, and remove unnecessary regulatory requirements.

3.3 In Australia there are a range of concessions within the tax system for small businesses, including exemptions, offsets, simplified processes and record keeping and payment arrangements. Tables A8.2 and A8.3 in Appendix 8 outline these concessions. Estimates in the *2006 Tax Expenditures Statement* indicate that the value of small business concessions will be over \$1 billion in 2006-07.⁷

3.4 Over the last decade the previous Government implemented initiatives seeking to identify and reduce red tape for business. Efforts were directed both at the regulatory requirements themselves and the ways in which they were administered. The most recent systemic review was the Banks Taskforce, which 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'.

7 The Treasury *2006 Tax Expenditures Statement*, Commonwealth of Australia.

3.5 The Banks report made 178 recommendations to reform existing regulation or investigate regulations in greater depth.⁸ The previous Government agreed in full or in part to 158 of the 178 recommendations in its final response to the report, released in August 2006.⁹

3.6 In releasing the Government response, the then Treasurer said:

Regulation is a major concern to all businesses and especially small businesses. The Australian Government is leading the way in reducing the burden of red tape to improve the economic environment further so that all businesses, large and small, can prosper and grow.¹⁰

3.7 The Taskforce made 20 recommendations in the area of tax regulation, of which 15 were agreed to by the previous Government in whole or in part. These were in the areas of fringe benefits tax (FBT), goods and services tax (GST), income tax, and harmonising tax definitions. They also referred five other areas for consideration by this review – see paragraph 2.3. Appendix 2 outlines progress in implementing the recommendations accepted by the previous Government.

RECENT POLICY CHANGES

3.8 In the 2006-07 and 2007-08 Budgets, the previous Government announced amendments to Commonwealth tax law aimed at easing small business tax compliance concerns, largely based on the Banks recommendations and submissions to it. In addition, the ATO has been implementing ongoing administrative initiatives to make it easier for small businesses and their agents to comply with tax and superannuation obligations. These recent initiatives are set out in greater detail in Appendices 6 and 7.

3.9 Many of these changes address some of the compliance concerns raised during this study, particularly in relation to the burden caused by inconsistent eligibility requirements for small business tax concessions. Possibly the most significant reform in this area was the announcement in September 2006 of the Small Business Framework, which allows eligible small businesses to choose from a broad range of tax concessions (see Box 3.1).

8 Banks report p iii.

9 The Australian Government's response is found on the Treasury website at: <http://www.treasury.gov.au>.

10 Treasurer's press release 2006/088, 15 August 2006.

Box 3.1: Small Business Framework

The *Tax Laws Amendment (Small Business) Act 2007* contained changes that standardised the eligibility criteria for accessing the small business concessions for goods and services tax, capital gains tax, fringe benefits tax, pay-as-you-go instalments and simplified depreciation and trading stock rules. Since 1 July 2007, small businesses have only needed to apply one eligibility test relating to the size of the business to access small business concessions. Any business with turnover of less than \$2 million can now access these concessions, subject to meeting any other specific requirements. Under the small business framework, the name 'the Simplified Tax System' (STS) has been repealed, but the former STS concessions for small business continue to be available.

Any entity that satisfies the small business entity test can choose to access the following concessions (subject to any additional criteria set out in the particular concessions):

- CGT 15-year asset exemption;
- CGT 50 per cent active asset reduction;
- CGT retirement exemption;
- CGT roll-over;
- simplified depreciation rules;
- simplified trading stock rules;
- immediate deduction for certain prepaid business expenses;
- choice to account for GST on a cash basis;
- annual apportionment of GST input tax credits;
- choice to pay GST by instalments;
- FBT car parking exemption; and
- PAYG instalments based on gross domestic product (GDP) adjusted notional tax (from 1 July 2009).

ATO INITIATIVES

3.10 As part of an ongoing effort to improve the interaction between taxpayers and tax administration, the ATO has undertaken an ongoing programme of measures aimed at assisting small businesses and other taxpayers with tax compliance. Many of the initiatives are computer-based. Details are contained at Appendix 7. These initiatives include:

- the 'easier, cheaper and more personalised program', which seeks to make it easier for taxpayers to understand their tax obligations, reduce the cost of compliance, and produce tax products and services that are consistent with taxpayers' everyday systems;
- the introduction of e-record, which is a free electronic record keeping product designed to make small business record keeping and the completion of Activity Statements easier;
- free small business tax seminars across Australia on basic (for example, record keeping) and more specialised topics (such as fuel tax credits and non-commercial loans);
- on-line facilities, such as the business portal, electronic forms that allow on-line lodgment, tools and calculators and a comprehensive 'For Business' section on the ATO's website www.ato.gov.au;
- the tax agent portal, which is a secure website available to registered tax agents providing them with access to live client account information and activity statements online. The portal has been identified by many tax agents as their preferred method of interaction with the ATO;
- ongoing liaison with software companies to integrate accounting software and tax lodgment and other reporting requirements;
- assistance to employers, including guidance on lodgment obligations, ABN registration, tax instalment deduction rates, and Superannuation Guarantee obligations; and
- extensive consultation mechanisms with small business and industry bodies.

3.11 In the 2007-08 Budget, the ATO received additional funding from 1 July 2007 for the New Business Intensive Assistance Program, which will enable improved support for new businesses, particularly those that prepare their own Business Activity Statements. This will involve the ATO conducting more face-to-face visits and providing increased telephone support to new businesses, aimed at helping them

better understand their GST and other record keeping obligations, and assisting them to develop good record keeping procedures.¹¹

3.12 In addition, in the 2007-08 Budget the ATO received funding of \$45.2 million over four years to assist the Department of Industry, Tourism and Resources, the Australian Securities and Investments Commission (ASIC) and IP Australia in the design and construction of a single streamlined online system to facilitate Australian Business Number (ABN) and business name registration. This system is expected to deliver significant cost savings for small to medium enterprises and will be implemented in collaboration with the State and Territory governments through the Council of Australian Governments (COAG).¹²

OTHER GOVERNMENT INITIATIVES

3.13 In recent years the previous Government introduced the following initiatives to help reduce compliance costs:

- improved consultation in the development of government regulation. In relation to tax in particular, the previous Government accepted in principle the recommendations of the Board of Taxation in its 2002 report on *Government Consultation with the Community on the Development of Taxation Legislation*.¹³ On 16 August 2007 the then Treasurer announced further improvements in consultation processes following acceptance of the Board of Taxation's report, *Improving Australia's Tax Consultation System*.¹⁴
- mandatory calculation of compliance costs when Government departments are costing new policy initiatives.¹⁵ The Office of Best Practice Regulation was formed to help administer this process. For taxation policy, a specialised tax compliance calculator was developed (Box 3.2 provides further information on compliance costs calculators);
- commencement of the Standard Business Reporting Programme, which is aimed at eliminating unnecessary or duplicated reporting to government and improving

11 Budget Paper No. 2, *Budget Measures 2007-08*, p 306.

12 See Media Release, The Hon Ian Macfarlane MP, 1 May 2007 'Global Integration: The Future for Australian Industry' and Budget Measures 2007-08 'Global Integration—Australian Business Number and business names registration system, Budget Paper No. 2', p 285.

13 Board of Taxation, 2002, 'Government Consultation with the Community on the Development of Taxation Legislation', A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer, March.

14 See Treasurer, 2007, 'Improving Australia's Tax Consultation System: Report by the Board of Taxation' Media release 076/2007. Further discussion on this report is contained in Chapter 8.

15 Press release issued by the Minister for Small Business and Tourism, 'Business Friendly Approach to Policy Development'. <http://minister.industry.gov.au/index>. 9 May 2006.

the interface between business and government agencies (Box 6.1 provides further information);

- expanded services to small businesses through www.business.gov.au, including the provision of additional online advice on regulatory requirements for new businesses;
- the Productivity Commission is undertaking a research study on performance indicators and reporting frameworks across all levels of government to assist COAG in implementing its in-principle decision to adopt a common framework for benchmarking, measuring and reporting on the regulatory burden on business. The first stage of this study was concluded with the release of the report *Performance Benchmarking of Australian Business Regulation* in March 2007. Stage two of the study involves benchmarking compliance costs in targeted areas. Information from this study should inform businesses about the easiest jurisdictions in which to do business and may ultimately lead to greater consistency in regulations across jurisdictions;¹⁶ and
- the Productivity Commission is also conducting ongoing annual reviews of the burdens on business arising from the stock of Australian Government regulation. The Commission is to review all Australian regulation impacting on industries cyclically every five years. The first review, which commenced in February 2007, is focused on Australia's primary sector.

Box 3.2: Compliance Cost Calculators

Tax system complexity and compliance costs are of concern because they reduce economic efficiency and can limit participation in economic activity, and those with the least economic capacity, such as small businesses, have the most difficulties coping with them.

Following its response to the Banks report, the previous Government established a new framework to improve the analysis applied to regulatory proposals and hence the quality of regulation. Under these arrangements all regulatory proposals must undergo a preliminary assessment to determine whether there will be compliance costs imposed on business or individuals. Where the compliance cost impacts are considered to be material, a quantitative assessment of the compliance cost impact is required.

The Business Cost Calculator (BCC) has been developed as a tool to be used by government agencies to assess compliance cost impacts of regulatory proposals on various affected groups and quantify them.

16 Productivity Commission, 2007, *Performance Benchmarking of Australian Business Regulation*, 19 February www.pc.gov.au/study/regulationbenchmarking/index.html.

Box 3.2: Compliance Cost Calculators (continued)

A specific Tax Compliance Cost Calculator (Tax CCC) has been developed by the ATO and Treasury for the assessment of taxation measures. The Tax CCC uses the same type of information as the BCC, but has been designed specifically for the analysis of taxation measures.

The Office of Best Practice Regulation (OBPR) has been assigned a central role in assisting regulators to meet the Government's best practice regulation requirements, and in monitoring and reporting on their performance. The OBPR is responsible for determining the appropriate level of regulatory analysis, and whether a quantitative compliance cost assessment or Regulation Impact Statement is required.

3.14 Several submissions to this study acknowledged the progress that has been made in recent years in addressing the compliance burden of taxpayers and agents through reviewing and reforming legislation and administration.¹⁷ Submissions also noted that there is still considerable work to be done in both streamlining tax law and simplifying tax administration, but they were less specific about where and how this could occur.

3.15 While the Banks review considered regulatory arrangements in a systemic way, many of the changes in taxation arrangements for small business have been piecemeal and in response to specific concerns. Over time a patchwork of arrangements for small business had built up, making it difficult for small businesses and their tax agents to navigate through. In addition, ongoing changes to the tax law themselves can be a major cause of compliance costs as small businesses and tax agents have to get across the changes.

3.16 The new small business framework is a significant step towards a more systemic approach to considering small business taxation arrangements, bringing a range of concessions into a single framework. In making future changes to the small business tax system, all stakeholders need to be mindful of not just the individual impacts of particular changes, but the cumulative impact of a range of changes over time.

17 Notably the CPA Australia and COSBOA submissions.

CHAPTER 4: THE NATURE OF SMALL BUSINESS

DEFINING SMALL BUSINESS

4.1 There is no standard measure of a 'small business' in Australian legislation. Turnover, numbers of employees, asset values and market share are some of the criteria that have been used to determine whether a business is 'small'. 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 have to make an assessment of whether they come within the various different definitions.

4.2 Until recently the *Income Tax Assessment Act 1997* contained several definitions of 'small business' for the purposes of the income tax law. Since 1 July 2007 a single consistent threshold – turnover under \$2 million – has been applied to determine eligibility for a variety of Australian Government small business tax concessions.¹⁸ Around 1.84 million businesses had turnover under \$2 million in 2006, comprising about 93 per cent of all businesses.¹⁹

4.3 Various criteria remain elsewhere in legislation. The *Privacy Act 1988* defines a small business as a business with turnover under \$3 million, while parts of the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001* use a measure based on numbers of employees.²⁰ A list of various definitions of small business in Commonwealth legislation is set out in Appendix 8. Most academic studies use the ABS definition of a small business, which is a non-agricultural business that employs 20 people or less.

4.4 The ATO refers to businesses with turnover of less than \$2 million per annum as 'micro businesses'. Businesses with turnover between \$2 million and \$10 million are generally regarded by the ATO as 'small businesses' although for statistical purposes

18 For details, see Minister for Revenue and Assistant Treasurer and Minister for Small Business and Tourism joint press release 2007/079, 'Benefits for Small Business take effect from 1 July 2007'.

19 ABS cat. no. 8165.0 *Counts of Australian Businesses, including Entries and Exits, June 2003 to June 2006*.

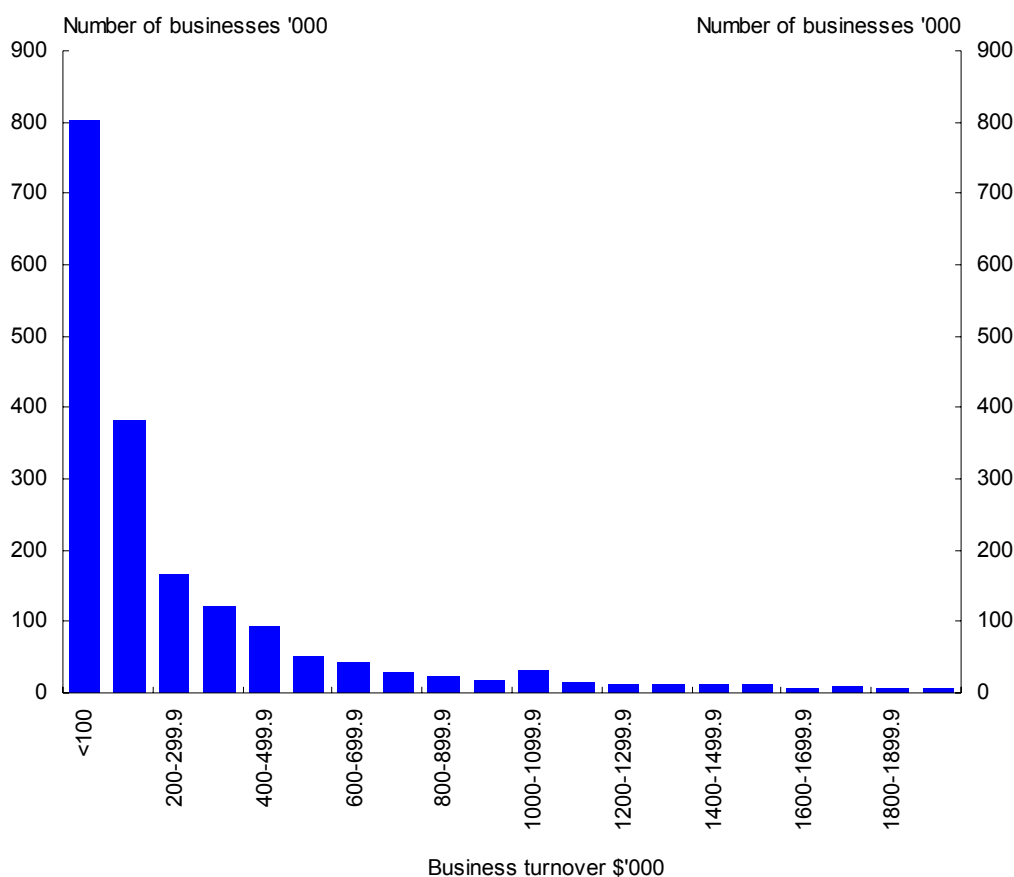
20 *Privacy Act 1988* – business where annual turnover is \$3 million or less; *Corporations Act 2001* (re financial services and markets) and *Australian Securities and Investments Commission Act 2001*: if a manufacturing business – 100 people, otherwise, 20 people.

they are usually included in the ‘small and medium enterprises’ category, which contains businesses with turnover between \$2 million and \$100 million.²¹

4.5 Chart 4.1 shows that most businesses in Australia are very small in terms of turnover. ABS data indicate that as at June 2006, around 800,000 businesses (around 40 per cent of all businesses, had turnover of less than \$100,000 per year and nearly 1.2 million businesses (around 60 per cent of all businesses) had turnover of less than \$200,000 per year.²² Chart 4.1 shows that business numbers decrease significantly as turnover rises.

4.6 This means that around 93 per cent of all businesses (1,837,503 in June 2006) fall into the ATO ‘micro-business’ category, with turnover of less than \$2 million per year. These micro businesses are the core of the small business community.

Chart 4.1: Numbers of businesses by annual turnover range, June 2006



(a) Source: ABS cat. no. 8165.0, unpublished data.

21 See for example the ATO 2006-07 Compliance Report. In the Business Perceptions surveys prepared regularly by Eureka Strategic Research for the ATO, the additional classification of ‘very micro businesses’ is used to describe those with turnover under \$50,000.

22 ABS cat. no. 8165.0 *Counts of Australian Businesses, including Entries and Exits, June 2003 to June 2006*.

Finding 1

The vast majority of Australian businesses are small businesses. Around 93 per cent of all Australian businesses by number have turnover of less than \$2 million per year.

FEATURES OF SMALL BUSINESSES

4.7 Australian small businesses have very diverse characteristics and the sector is very dynamic. Small businesses comprise sole traders, partnerships, trusts and companies and they operate in every industry and in every State and Territory, and are operated by the young to the very old. To the extent that is possible to generalise, according to the ABS the most common small businessperson is a middle-aged man working between 35 and 50 hours per week from home without any staff.²³ Box 4.1 provides a snapshot of the small business sector in 2004, based on ABS data.

Box 4.1: Features of small businesses in Australia²⁴

In June 2004:

- 68.1 per cent of all non-agricultural small business operators were male.
- Of the 1.1 million full-time small business operators, 65.1 per cent worked between 35 and 50 hours per week, while 30.2 per cent worked between 51 and 75 hours per week.
- 59.4 per cent of small business operators were aged between 30 and 50 years, with the proportion of operators over 50 years increasing by 7 per cent since 1995.
- 56.3 per cent of small businesses did not employ staff, while 32.8 per cent employed 1-4 staff and 10.9 per cent employed 5-19 staff.
- 30.2 per cent of small business operators were born overseas.
- 33.5 per cent of small businesses had been in operation between 1 and 5 years, but for employing businesses the majority had been in operation for 10 years or more.
- 71.7 per cent of small businesses use computers in their business operations, with 62.3 per cent of these having access to the Internet. 93.0 per cent of businesses employing 5-19 staff used a computer.
- 67.5 per cent of all small businesses were home-based, and were operated by 1,040,000 people, with home-based businesses predominantly (65.5 per cent) operated by males.

23 ABS Media release 2005/56 'Small business operators ageing: ABS', 28 April 2005.

24 ABS cat. no. 8127.0 *Characteristics of Small Business, Australia*. The definition of small businesses used by the ABS in this survey does not include agricultural businesses.

IMPORTANCE OF SMALL BUSINESS IN THE ECONOMY

4.8 Small businesses account for around 39 per cent of Australia's economic production and employ around 3.7 million people.²⁵ Over 70 per cent of those employed in the construction sector and over 60 per cent of those employed in the personal and other services sector are employed in small businesses.²⁶ In addition, small businesses make up around 49 per cent of all exporting businesses (although they contributed only around 1 per cent to the value of total exports).²⁷

Industry distribution

4.9 As Chart 4.2 shows, small businesses operate across all businesses sectors, with the property and business services sector being the dominant sector for small businesses. Just over one-quarter of all businesses are operating in this sector.²⁸ A significant number of small businesses are also operating in the construction, retail trade and agricultural sectors.

Finding 2

Small businesses are very important to the Australian economy. They produce around 39 per cent of Australia's industry value added and employ almost half the non-agricultural workforce. Most are engaged in the property and business services, agriculture, construction and retail sectors.

Business structures and numbers of employees

4.10 Table 4.1 shows Australian small businesses as at June 2006 categorised by their business structure and the number of staff they employ. Around one-third of all businesses are sole proprietorships, with a significant number employing no staff. Just under another third use a company structure, with the around half of these businesses employing between one and four staff.

4.11 Overall around 60 per cent of all small businesses do not employ any staff. Many of these small businesses are self-employed people who have in a sense bought themselves a job by establishing their own business. Their perceptions of tax compliance costs tend to differ somewhat from those who consider themselves as

25 ABS cat. no. 8155.0 *Australian Industry 2004-05*. Economic production is measured by Industry Value Added, which is a measure of the contribution by businesses to gross domestic product.

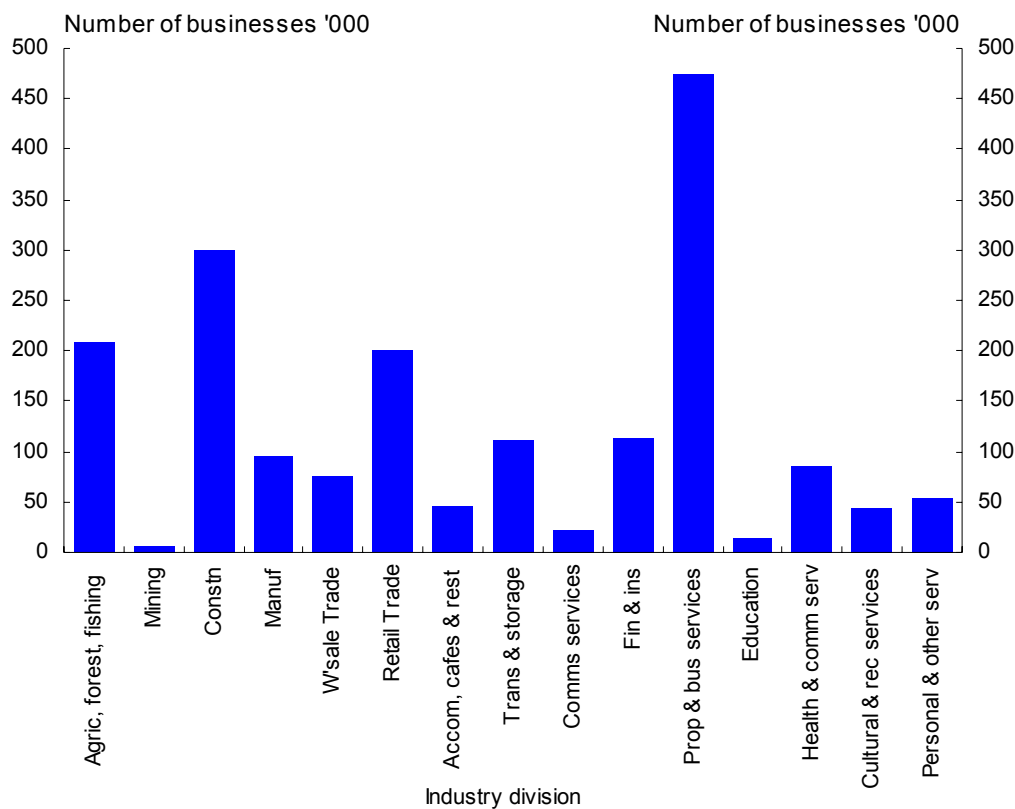
26 ABS cat. no. 8155.0 Table 2.1 pp 20 and 30.

27 ABS cat. no. 5368.0.55.006 *Number and Characteristics of Australian Exporters, 2005-06*.

28 The property and business services industry division includes businesses engaged in renting and leasing assets, scientific research, architectural, surveying and engineering services, computer consultancy and maintenance and data processing, legal services, accounting services, marketing and advertising, business management, employment services, security and cleaning.

'business people', as they tend to have an expectation that their tax compliance costs should be no greater than those of an employee.

Chart 4.2: Private sector small businesses by Industry Division (ANZSIC classification)



Source: ABS cat. No. 8165.0 *Counts of Australian Businesses, including Entries and Exits, June 2003 to June 2006*, unpublished data. Industry sectors with an insignificant number of businesses have been omitted from this chart.

Table 4.1: Small business structures and numbers of employees²⁹

	Non employing	1-4 employees	5-19 employees	Total small businesses	As a proportion of small businesses (per cent)
Sole proprietorships	500,876	76,495	19,672	597,043	33.2
Partnerships	267,630	75,410	35,338	378,378	21.0
Companies	180,636	245,729	98,858	525,223	29.2
Trusts	172,658	81,089	44,033	297,780	16.6
Total	1,121,800	478,723	197,901	1,798,424	100

Source: ABS cat. no. 8165.0.

²⁹ Data includes businesses with turnover less than \$2 million and employment of less than 20 people.

Age of operators

4.12 Small business operators reflect the national trend of an ageing population. In June 2004, 31 per cent of all operators were older than 50 years, compared with 23 per cent of all operators in February 1995. The proportion of male operators aged more than 50 years increased from 25 per cent to 32 per cent and female operators from 19 per cent to 29 per cent over the same period.³⁰

Age of businesses

4.13 Business failure rates are not as high as is commonly believed. Research undertaken by the Productivity Commission in 2000 indicated that around two-thirds of businesses survive the first five years of operation, and that the majority of businesses that cease operation do not close because of 'failure' but for reasons unrelated to their financial position. The research showed that only around 2 per cent of businesses cease operations each year because the owners, while solvent, cannot secure a sufficient return, and only 0.5 per cent of businesses cease operation each year due to insolvency.³¹

4.14 More recent data from the ABS give a higher figure for business closures, with 15.3 per cent of small businesses that employed fewer than 20 staff ceasing operations in 2005-06. The corresponding entry rate for new businesses in 2005-06 was 16.7 per cent.³² The ATO estimates that around 10 per cent of micro-businesses are new to business each year, and many of these businesses may have limited experience with the business tax system.³³

4.15 The first few years in the life of a small business are the most risky, and over the short to medium term, business survival is very much dependent on the age of the business. The longer a business survives, the greater its chances of continuing survival.

4.16 In addition, businesses that employ staff tend to survive longer than non-employing businesses. For example, of the businesses that began operation in 2003-04, only 50 per cent of non-employing businesses were still operating in June 2006, compared with 80 per cent of employing businesses.³⁴ ABS data show that the majority of non-employing businesses at June 2004 had been in operation for one to

30 ABS Media release 2005/56 April 28 2005.

31 Productivity Commission, 2000, *Business Failure and Change: An Australian Perspective* Staff Research Paper at <http://www.pc.gov.au/research/staffres/bfacaap/index.html>.

32 ABS cat. no. 8165.0, *Counts of Australian Businesses, including Entries and Exits*, table 10, p 14.

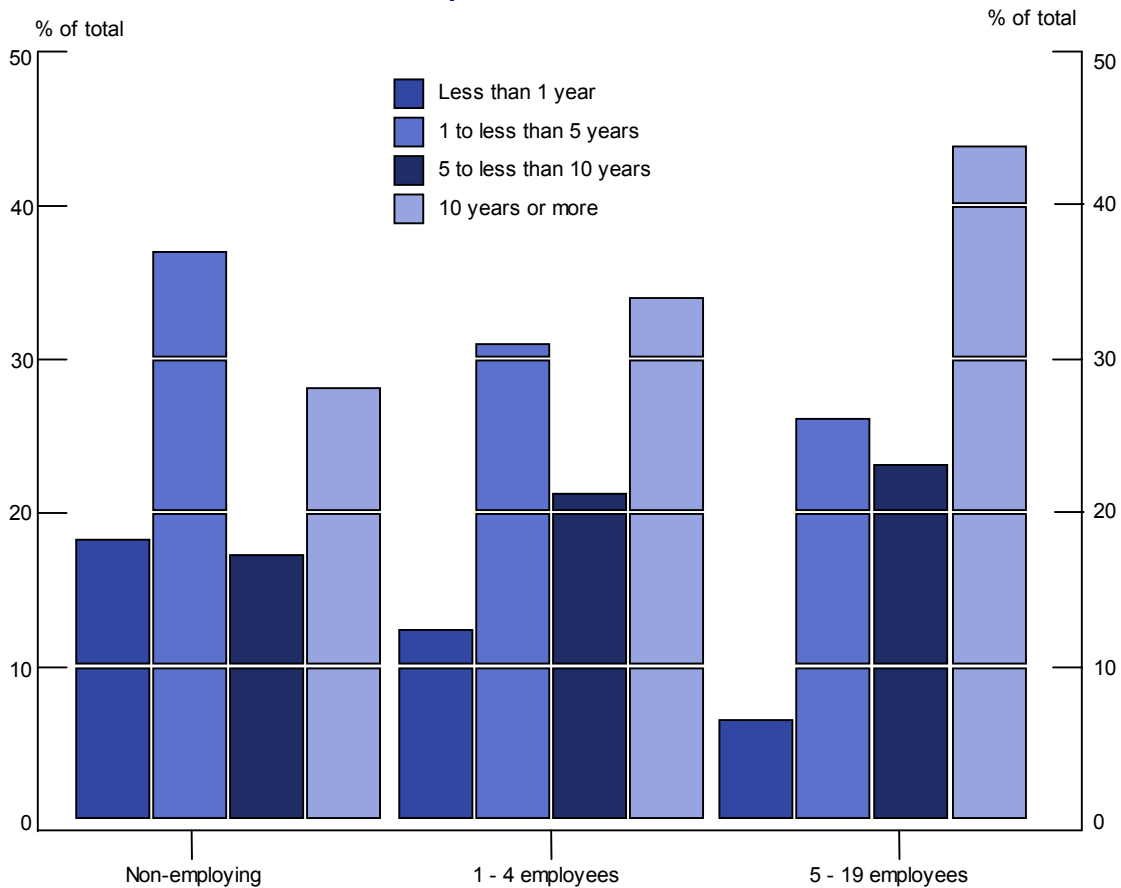
33 *ATO Compliance Program 2006-07* p 15.

34 ABS cat. no. 8165.0, *Counts of Australian Businesses, including Entries and Exits, June 2003 to June 2006* media release 26/2007, 26 February 2007.

less than five years. However, the majority of businesses employing one to 19 employees had been in operation for 10 years or more.³⁵

4.17 Chart 4.3 shows the relationship between the length of operation of Australian small businesses and the number of employees in 2004.

Chart 4.3: Proportion of businesses, by employment size group and length of operation, June 2004



Source: ABS cat. no. 8127.0, summary.

SMALL BUSINESS AND TAXATION

Business structures and taxation

4.18 As Table 4.1 shows, just over 50 per cent of small businesses in Australia are sole traders or partnerships and many micro-businesses are content to continue to use these more simple business structures. These business operators pay income tax at their own personal marginal tax rates. This will have tax advantages for these business

35 ABS cat. no. 8127.0 *Characteristics of Small Business Australia (Re-issue) 2004*, summary.

proprietors as long as their average personal income tax rate is below the company income tax rate.³⁶

4.19 However, as business opportunities expand, some proprietors find that there are advantages in incorporation, despite the increased compliance requirements that it may bring. Becoming an incorporated enterprise may reduce the risks to the owners of running a business by providing limited liability to all shareholders, subject to personal guarantees that are often required. In addition, some businesses find that a company structure is advantageous, or sometimes necessary, when seeking to enter into business contracts. Nevertheless, for many businesses it is the difference between the company tax rate and their personal marginal tax rate that drives the decision to incorporate. At the time of making that decision to incorporate they may not be fully aware of the possible consequences of incorporation to their tax compliance costs.

Taxes paid by small businesses

4.20 Small business involvement in the tax system often extends beyond the payment of income tax. Depending on their nature and size, small businesses are also likely to pay GST and complete a BAS. ATO data show that while most small businesses prepare their own BAS (often with the assistance of bookkeepers), 95 per cent have their income tax returns prepared by tax agents, indicating the significant role of tax agents in small business tax compliance. If a small business employs staff, its involvement in the tax system will be even more complex and may involve the payment of pay-as-you-go (withholding) (PAYG (W)), FBT, superannuation, and state payroll tax.

Micro-businesses

4.21 Table 4.2 provides ATO data which break down the number of taxpaying micro-businesses by type of business structure and the extent to which they are liable for income tax, GST and FBT.

4.22 While unincorporated businesses are liable for very little FBT, they are liable for a significant amount of GST. Businesses with turnover over \$75,000 are required to register for GST³⁷, and smaller businesses can register if they wish to claim input tax credits, but then have to comply with additional reporting requirements. The relatively high number of businesses that register voluntarily potentially reflects the importance

36 Australia has a progressive income tax system with marginal tax rates stepping higher as incomes rise. A taxpayer's marginal rate is the rate of tax that applies to the highest dollar they earn, whereas their average tax rate is the total amount of tax they pay, divided by their taxable income. Company income tax is applied at a flat rate of 30 per cent.

37 The threshold was increased to \$75,000 from 1 July 2007. Between 1 July 2000 and 30 June 2007 the GST registration threshold was \$50,000.

of input tax credits to them or their perception that their customers may prefer to deal with GST registered businesses.

Table 4.2: Micro-businesses: Taxpaying profile, 2004-05

	Taxpayers and \$ tax liability					
	Income tax		GST		FBT	
	No. of entities	\$m	No. of entities	\$m	No. of entities	\$m
Individuals	1,532,079	16,034	924,524	1,071	214	1
Partnerships	368,200	0 ³⁸	320,708	1,525	452	2
Trusts	215,431	0 ³⁹	188,550	1,755	3,565	22
Companies	689,915	6,227	573,228	3,607	18,036	122
Total	2,805,625	22,261	2,007,010	7,958	22,267	147

Source: ATO. Based on tax returns processed to 18 May 2007 for entities that have lodged their 2004-05 income tax return. Data is rounded to the nearest \$ million. The GST turnover threshold was \$50,000 in 2004-05.

4.23 The ATO's 2006-07 Compliance Program data indicate that micro-businesses pay around 11 per cent of total Australian Government tax collected, including 13 per cent of all income tax from companies and 25 per cent of all GST. Micro-businesses also contribute an additional 7 per cent of net ATO collections through amounts withheld from payments to employees.

4.24 The ATO notes that, as a group, micro-businesses generally have limited time, knowledge and resources to manage their tax affairs. When difficulties arise in tax compliance, they are generally in the areas of: registering in the tax system; record keeping; lodging on time; reporting information (including compliance with the tax and superannuation laws); and paying tax on time. For 2005-06, 67 per cent of total debt outstanding to the ATO was owed by micro-businesses.⁴⁰

Businesses with turnover between \$2 million and \$5 million

4.25 Businesses with turnover between \$2 and \$5 million tend to operate at a slightly higher level of organisation and sophistication than micro-businesses. According to the ABS, in June 2006 there were around 50,000 businesses with turnover of between \$2 million and \$5 million that employed less than 20 people.⁴¹

38 Partnerships do not pay tax. Profits or losses are distributed to the partners who account for the distribution or loss in their tax returns. Similarly trusts are not entities for income tax purposes and the trustee (often a company) or the beneficiaries pay tax on any net taxable income.

39 See previous footnote.

40 Australian Taxation Office 2006-07 Compliance Program publication NAT 7769-08.06, p 15.

41 ABS cat. no. 8165.0, June 2006, unpublished data.

4.26 Table 4.3 shows that a much smaller proportion of this group are liable for taxation as individuals and a greater proportion are incorporated compared with micro-businesses.

Table 4.3: Small businesses with turnover between \$2 million and \$5 million: Taxpaying profile, 2004-05

	Taxpayers and \$ tax liability					
	Income tax		GST		FBT	
	No. of entities	\$m	No. of entities	\$m	No. of entities	\$m
Individuals	2,698	367	2,273	-117	28	0
Partnerships	4,919	0 ⁴²	4,683	102	288	3
Trusts	11,710	0 ⁴³	11,283	815	1,832	20
Companies	31,237	2 564	30,929	2 108	7,284	98
Total	50,564	2 931	49,168	2 908	9,432	121

Source: ATO: Based on tax returns processed to 18 May 2007 for entities that have lodged their 2004-05 income tax return. Data is rounded to the nearest \$ million.

THE NOT-FOR-PROFIT SECTOR

4.27 There are around 700,000 ‘not-for-profit’ organisations in Australia. Participants in the not-for-profit sector are not established for ‘business’ outcomes and they do not generally come within definitions of small business. However, tax compliance cost issues for the not-for-profit sector are considered briefly as part of this study.

4.28 The not-for-profit sector includes charities, deductible gift recipients, public benevolent institutions and other organisations, which can use a variety of legal structures. The principal characteristic that distinguishes not-for-profit organisations from other organisations is that they cannot distribute their gains or profits to their members, owners or managers. Their objectives are community outcomes, generally altruistic.

4.29 Small not-for-profit organisations can face similar compliance costs to those of small businesses in respect of some taxes. They may also have complex compliance issues in accessing tax concessions available to them.

42 Partnerships do not pay tax. Profits or losses are distributed to the partners who account for the distribution or loss in their tax returns. Similarly trusts are not entities for income tax purposes and the trustee (often a company) or the beneficiaries pay tax on any net taxable income.

43 See previous footnote.

4.30 While very few not-for-profits are required to lodge income tax returns, depending on their particular circumstances they may be required to:

- lodge a monthly or quarterly BAS;
- lodge annual FBT returns (the provision of fringe benefits by not-for-profit organisations to their employees is quite prevalent as a result of the capped rebates or exemptions available to many of them); and
- maintain particular records to evidence concessional tax compliance requirements, for example, in relation to non-commercial activities and GST free supplies.

4.31 Another key challenge for small not-for-profit organisations is a lack of resources to manage their tax compliance obligations properly. Most rely on volunteers or a small number of employees for their administration activities and these volunteers may not have all of the skills necessary to deal with taxation issues. Perhaps more often than is the case for profit making businesses, they may also lack the financial resources to engage tax professionals. Allowance is not always made (or fully made) for these administrative costs in the funding provided for not-for-profit activities.

Finding 3

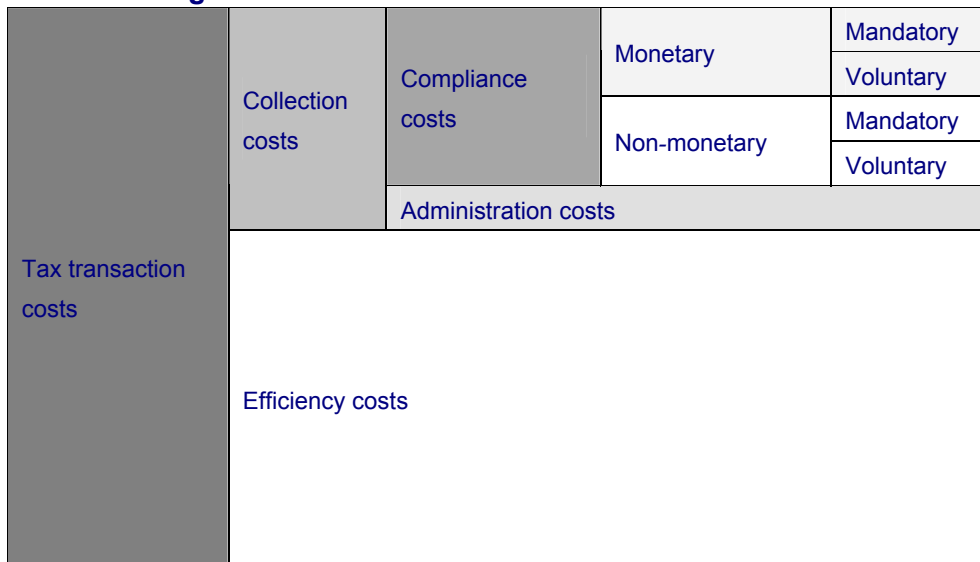
While not-for-profit organisations are not generally established for business purposes, in some respects they may experience similar compliance issues to small businesses.

CHAPTER 5: THE NATURE OF COMPLIANCE COSTS

5.1 The Government collects taxes to fund essential public expenditures but the ‘cost’ to society of taxation is generally greater than just the amount of taxes collected. There will always be some level of costs associated with raising the revenue. Tax ‘compliance costs’ represent the additional costs, in terms of time, effort and financial expense, that taxpayers must bear as a part of meeting their taxation obligations, over and above the cost of keeping records and accounts as a normal incident of carrying on a business.

5.2 There are many ways to classify these costs. Oliver and Bartley (2005)⁴⁴ divide tax transaction costs into two main types: collection costs, which comprise government administration costs and compliance costs; and efficiency costs, which represent the distortion to optimal resource allocation caused by taxation, with efficiency costs significantly exceeding collection costs. Collection costs can be further classified as administration costs and compliance costs, the latter of which can be either mandatory or voluntary. Figure 5.1 shows Oliver and Bartley’s diagrammatic representation of tax transaction costs.

Figure 5.1: A breakdown of tax transaction costs



Source: Oliver and Bartley (2005) p 55.

44 Tracy Oliver and Scott Bartley, 2005, Tax system complexity and compliance costs – some theoretical considerations. *Economic Roundup*, Winter pp 53-68.

5.3 The cost of administering and complying with the tax law is a deadweight cost to the community that should be minimised on economic efficiency grounds. The higher these costs, the lower the socially desirable level of government and/or privately provided goods and services, other things being equal.⁴⁵

5.4 Compliance costs generally refer to the incremental burden that businesses bear in abiding with regulation. They are additional to the costs otherwise incurred in running their business. In relation to tax, compliance costs need to be distinguished from the amount of tax that has to be paid and the accounting and record keeping requirements of running a business.

5.5 Some accounting and record keeping costs are an essential part of running a business and they are not compliance costs associated with taxation obligations. Likewise, several of the additional costs that business owners incur when expanded business opportunities lead them to incorporate, are not regulatory compliance costs per se. Pure tax compliance costs will be minimised when legislative and tax collection agency requirements are aligned with the record keeping required in normal business accounting practices. As far back as 1996, the Bell Report noted that the more clearly aligned current business practices are to best practice and to regulatory requirements, the lesser the burden a business is likely to face.⁴⁶ However, while the tax laws have some grounding in accounting concepts, there are differences in purpose and policy so it is not always possible to align the two concepts.⁴⁷

5.6 While there is no doubt that taxation compliance costs are burdensome to many small businesses, it is not clear the extent to which businesses are able to distinguish these costs from the accounting and information technology costs that would have been incurred in any event in the natural course of running a business. This makes it very difficult to accurately measure the extent of the small business tax compliance burden.⁴⁸

5.7 Feedback and research suggests that non-taxation compliance costs are also a significant issue in particular industries and situations, and sometimes, more burdensome than tax compliance costs. Businesses that employ staff and which operate in the construction and agricultural industries, in particular, appear to face significant non-tax compliance costs. Chapter 10 describes some of the key non-taxation compliance costs identified by this review.

45 Oliver and Bartley, 2005, p 55.

46 Bell, C, 1996, *Time for Business – Report of the Small Business Deregulation Task Force*, November, p 15.

47 See the speech by Michael D’Ascenzo and Andrew England, ‘The Tax and Accounting Interface’ 15th Australasian Tax Teachers Association Conference, University of Wollongong 31 January 2003 at <http://www.ato.gov.au/corporate/content.asp?doc=/content/29545.htm>.

48 This issue is explored in ‘Compliance Costs of Taxation in Australia’, 1996, Office of Regulation Review Report, July, p 6.

5.8 Businesses may incur voluntary⁴⁹ compliance costs when they choose to evaluate alternative methods of complying with the tax law to determine the most favourable tax outcome, either by themselves or by engaging a tax agent; or where they choose structures that may give rise to additional costs. They are a product of the legal requirements of taxpayers and choice in the tax system. Mandatory costs are those that must be incurred to meet their statutory obligations which would not otherwise have been incurred in the absence of the tax law.

5.9 Generally, research suggests that the extent to which small businesses incur significant regulatory compliance costs depends on the type of business, the age of the business, the industry in which the business operates, and significantly, whether the business employs staff. This study has confirmed this general view. The drivers of compliance costs are discussed in Chapter 6 of this report.

TYPES OF COMPLIANCE COSTS

5.10 There is extensive international literature on the measurement of compliance costs in qualitative and quantitative terms, but little agreement on whether or how they can be measured accurately. Several qualitative and quantitative studies have been undertaken in Australia in the last 15 or so years and a summary of their key findings is found in Appendix 5.

5.11 Overall, the literature categorises compliance costs into four types: financial; psychological; temporal; and opportunity costs.

Financial compliance costs

5.12 Financial compliance costs are probably the most easily measured. Financial compliance costs are payments made to external advisers or internal staff to undertake regulatory obligations on behalf of the business, or spent on the purchase of materials or software to be used for the purpose of fulfilling regulatory requirements (aside from normal accounting requirements). There may be associated managerial benefits arising from these costs, such as more efficient, complete or accurate business records.

5.13 Small businesses may incur significant financial tax compliance costs. These could include the costs of implementing specific systems to comply with the tax law, such as specialised computer software systems, tax agents' fees, and costs of records storage for a statutory period. The critical issue is whether the benefits of small businesses using their time in some other way (the opportunity benefits) and the efficiency gains from using technology outweigh these financial costs.

49 Voluntary compliance costs are any non-mandatory costs, but some of these may nevertheless be sensible business practice in a competitive business environment.

Psychological costs

5.14 Psychological costs represent the stress and other behavioural impacts that affect individuals engaged in business due to their fear about whether they are abiding by business regulations. These costs are difficult to measure. The Atax study suggested that new micro-businesses may experience a lower level of psychological stress because they are not yet aware of the regulatory requirements that they must comply with. The longer a business is in operation, the more aware business operators become of the regulatory systems and the more stressful their compliance obligations may become. However, over time they will become accustomed to the regulatory requirements and put systems in place to manage them, lowering stress levels again. Psychological costs are therefore likely to vary over time. Chart 6.1 in Chapter 6 represents these transitional phases diagrammatically.

5.15 The extent of known compliance activity by the regulatory authorities may also affect a business proprietor's psychological stress. Atax's research indicated that most of the small businesses interviewed were aware that they might be breaching occupational health and safety rules (and some other non-tax regulations), yet were willing to run this risk because they felt the rules were not always actively enforced or they regarded them as impossible to comply with in the context of their business. The consequences of *tax* non-compliance, however, were known and a source of some stress, to the point that businesses would outsource their tax compliance activities to ensure they were compliant, converting their psychological stress into a financial cost.

5.16 Atax also noted that the owners' confidence in their tax agent and/or their own accounting systems affected the extent of their psychological stress, as did the nature of their business – those without employees, a self-managed superannuation fund, cashflow constraints, or profitability concerns felt least stress.

Temporal and opportunity costs

5.17 Temporal costs are the amount of time that business owners spend personally, or by using unpaid helpers, to undertake compliance activities. Opportunity costs are the costs of being unable to undertake an activity because of a requirement to complete another task.⁵⁰ In most cases temporal and opportunity costs would be linked, as time spent on tax compliance activities represents time that cannot be spent on the core activities of the business. A loss of core business time was perceived by small business operators as impacting on business performance, business growth and their general wellbeing, thus affecting their ability to remain in business over the longer term.

5.18 Outsourcing tax compliance activities to tax professionals converts temporal, opportunity and psychological costs into a financial cost, by reducing the responsibility

50 And opportunity benefits are the benefits associated with that other activity.

on the small business proprietor to undertake tax obligations themselves, which leaves them with more time to run their business. For many small businesses, this may be a sensible option.

Transitional and ongoing compliance costs

5.19 Transitional compliance costs are those brought about by a change in tax requirements. Businesses may, either voluntarily or compulsorily, incur transitional compliance costs to help them introduce systems and practices that will enable them to comply with the new aspects of the law. By their nature, they should be short-lived; once the change has been implemented and routines established, these costs should diminish. Both start-up and temporary costs are considered transitional costs. Start-up costs might include the purchase of equipment, software, training and staff familiarisation with the new tax. Temporary costs might include the extra time taken to comply with new obligations as staff and tax authorities become familiar with the new rules.

5.20 In addition to the transitional costs that a business may incur in implementing changes to the tax system, there may also be recurrent or ongoing compliance costs for the business. Ongoing compliance costs may include requirements such as collection, recording, processing and storage of data, use of software and computers, preparation and lodgment of documentation, and liaison/transactions with tax practitioners and the ATO.

5.21 When the introduction of a tax change leads to these recurrent costs being greater than those that would have been borne under the pre-change tax system, there would be incremental recurrent costs. On the other hand, if the introduction of a change to the tax system leads to a reduction in compliance costs relative to the existing system, there would be an incremental compliance benefit.⁵¹ Clearly, if reducing compliance costs is a priority for governments, changes to the tax system should be designed to bring about an incremental compliance benefit while still achieving other policy and administrative objectives.

5.22 At times of ongoing, rolling change to the tax system, small businesses may have little opportunity to bed down their administrative practices before additional modifications to the tax system take place. In this case, small businesses may perceive that they are experiencing ongoing transitional costs and it may be difficult for them to determine what the extent of the ongoing tax compliance burden might be.

51 See 'Evaluating the compliance costs and benefits of the Tax Value Method' A report prepared for the Board of Taxation, 6 May 2002, Associate Professor Chris Evans and Dr Binh Tran-Nam pp 6, 17-19.

IMPACT OF COMPLIANCE COSTS ON SMALL BUSINESS

5.23 It is generally acknowledged in academic literature and by governments internationally that tax compliance costs for small businesses are regressive. This means that the cost of complying with the tax system imposes a greater proportional burden on smaller businesses than larger ones, because some of the costs involved are relatively 'fixed' or 'lumpy' and do not rise proportionately with turnover. Therefore, small businesses cannot take advantage of economies of scale, whereby average costs fall as business size increases.

5.24 In addition, small businesses are often logistically and administratively under-equipped to cope quickly with changes in the tax system. Submissions to the Banks review suggested that compliance matters can consume up to 25 per cent of the time of senior management and boards of large companies. The impact may be even greater for some small businesses because they do not have the in-house capacity to keep on top of ongoing changes to regulation, and may even crowd out productive activity in the small business sector.⁵²

5.25 Several governments worldwide have acknowledged the relatively high tax compliance burden on small businesses by allowing small and medium-sized businesses to be taxed under a simplified tax structure, keep less detailed financial accounts, or lodge tax payments less frequently to reduce compliance costs.

Finding 4

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, the smaller the business.

Finding 5

Governments, both in Australia and internationally, have recognised that small businesses have proportionately higher tax compliance costs and have introduced initiatives to try to reduce these costs.

Finding 6

Compliance costs can be both financial and non-financial. In some cases, non-financial compliance costs, such as stress and time lost, can be just as significant, if not more so, than the financial compliance costs. Many small businesses choose to replace stress and time costs with financial costs by paying tax agents and bookkeepers to assist in meeting their tax compliance obligations.

52 Banks Report p ii.

Finding 7

Small businesses may become confused about what tax compliance costs are. They do not always distinguish between tax compliance costs and either the amount of tax they have to pay or the general accounting and record keeping costs that are an essential part of running an effective business.

BENEFITS OF TAX COMPLIANCE

5.26 In considering compliance costs, it is also necessary to have regard to the benefits that might arise from tax compliance which reduce the impact of compliance costs. Studies have suggested that benefits from tax compliance might include managerial benefits arising from better record keeping systems for decision making, cash flow benefits, tax deductibility and grants from governments.

5.27 One small business owner commented to the Board:

When the GST came in and I was forced to buy a computer to do my books, it was the happiest day of my life.

5.28 Despite this, the Board was unable to find a consensus view about whether small businesses received significant extra advantages from tax compliance. Tax agents interviewed noted that while clients universally complained about the burden of tax compliance, the extent of complaint depended on the level of business acumen and the computing skills of the individual person, with the more sophisticated, experienced (but younger) business owners tending to use computer-based systems for a wide range of business analysis, as well as tax compliance. Some business proprietors also commented on the cash flow benefits of receiving GST refunds throughout the year.

5.29 The 2003 CPA survey of small business compliance burden found that 75 per cent of small businesses surveyed claimed that compliance obligations act as an incentive to keep up to date with record keeping. As a result, they run financial reports regularly to manage the business. Sixty-two per cent of small businesses surveyed resented the time needed to comply with tax obligations and 41 per cent felt the paperwork burden had increased to the point where they questioned staying in business.⁵³

5.30 However, Atax found that business proprietors accepted that the completion of a BAS each quarter provided a good snapshot of the business, and that the BAS forced them to be more disciplined in their reconciliations, which made the end of the year easier. Businesses with mostly GST free supplies commented that submitting a quarterly BAS had a positive impact on cash flow.

53 CPA Australia, Small Business Survey Program: Compliance Burden April 2003.

5.31 Nevertheless, Atax concluded that overall, the benefits of tax compliance to business were perceived as marginal. They considered that the most widely held view amongst the businesses they interviewed was that accounting, record keeping and tax compliance activities did not give rise to incidental benefits to small business (in that they felt they monitored business performance anyway) other than perhaps to make the preparation of the annual income tax return easier, which was not a benefit as such, but more a re-allocation of time spent.⁵⁴ This may in part reflect difficulties in distinguishing tax compliance costs from the accounting and record keeping requirements necessary for running a business.

5.32 Discussions with small businesses and tax agents suggested that there may sometimes be a difference in the perception of the benefits of tax compliance between small businesses and the tax agents that provide services to them. Some tax agents considered that businesses perceived that there were few benefits from tax compliance because the business proprietors confused the payment of tax itself with the compliance cost burden. By contrast, tax agents saw tax reporting requirements as a means of keeping business records on track.

Finding 8

Tax compliance may provide benefits to businesses by imposing a discipline that allows them to better monitor and understand their business dealings and cash flow. Tax agents are often more likely to recognise these benefits than small businesses themselves.

54 Atax p 29.

CHAPTER 6: DRIVERS OF SMALL BUSINESS TAX COMPLIANCE COSTS

6.1 Tax compliance costs do not affect all small businesses equally. Both the unique features of the individual businesses and their engagement with the external environment determine the nature and extent of their compliance costs, both actual and perceived. The 1.84 million Australian small businesses that are engaged in a wide range of commercial activities are affected differently by the regulatory environment around them and consequently all have a different compliance cost experience.

Finding 9

The small business sector is extremely diverse and the compliance costs of small businesses are influenced by a range of factors. As a result, the experience of both tax and non-tax compliance costs can vary significantly from business to business. For some businesses, tax compliance costs will dominate, but for others, non-tax compliance costs will be more significant.

6.2 This chapter identifies the factors that appear to be influencing the tax and non-tax compliance costs of Australian small businesses. The aspects of the business itself that may influence compliance costs include:

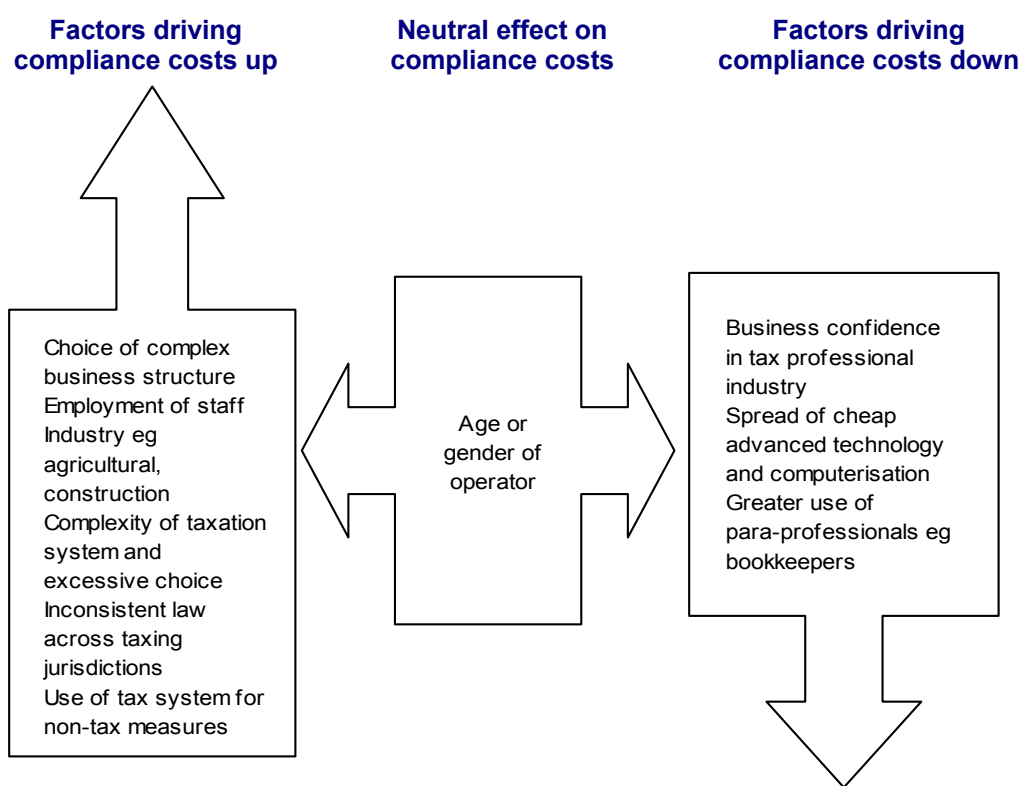
- the age, structure and turnover of the business;
- the industry in which it operates;
- the location of the business;
- whether it engages in interstate or overseas trade;
- the owner's personal characteristics;
- the extent of computerisation and use of accounting systems; and
- whether it employs staff.

6.3 Some of the external factors over which individual businesses have very little control, but which may affect compliance costs, include:

- the structure of the taxation system;
- federal inter-governmental relations; and
- economy-wide technological developments.

6.4 Figure 6.1 indicates the broad influence of these various factors on tax compliance costs.

Figure 6.1: Drivers of small business tax compliance costs



AGE, STRUCTURE AND TURNOVER OF BUSINESSES

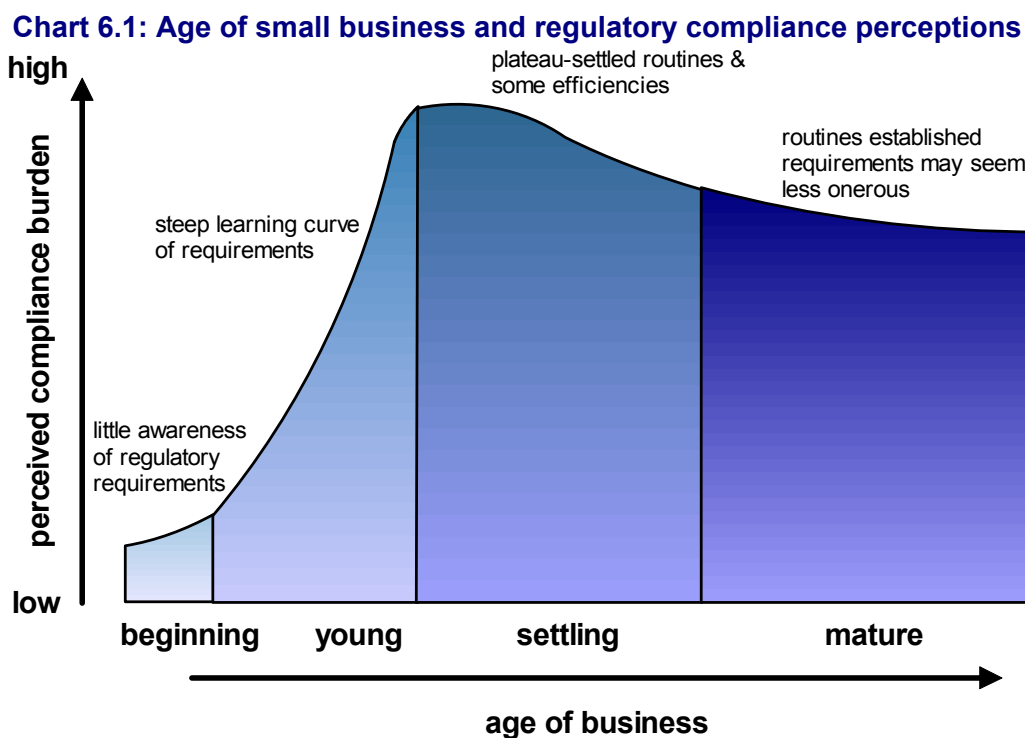
6.5 Research and discussions with small businesses and tax agents suggest that there is generally a simple link between the age of a business, its turnover and the business structure it uses. New businesses tend to start small with low turnover and simple business structures. As businesses become more successful over time and turnover grows, owners tend to favour more complex business structures, particularly incorporation, to minimise risk and tax. This can increase both tax and non-tax compliance costs.

Age and turnover

6.6 While the Board's consultations with tax agents and businesses suggested that older businesses established before 2000 appeared to cope well with the changes brought about by The New Tax System, other research suggested that the older businesses were having more difficulty dealing with tax compliance obligations. Atax reported that businesses that had set up after GST (2000) appeared to be less stressed by their tax compliance obligations than those established before the GST. This difference may reflect a balance between well-established businesses being comfortable with the operation of the business itself and new businesses being more comfortable adapting to changes in taxation arrangements, particularly through the use of technology.

6.7 There was, however, general acceptance that very new businesses (that is, those in their first year) felt less burdened by regulation, perhaps because they were less aware of the regulations that might apply to them and were more likely to admit to non-compliance. As they become more aware, they may feel more burdened by the start-up compliance costs, such as registration and licensing requirements, as well as the new ongoing requirements such as GST collection and the completion of a BAS.

6.8 Chart 6.1 below shows a generalised interpretation of the relationship between the age of small businesses and their perception of the regulatory burden they face. In many cases, beginning businesses are unaware of business requirements, and in some cases 'fly under the regulation radar' for as long as possible. Once businesses become aware of their compliance responsibilities, the need to develop systems to assist with compliance places them on a steep learning curve. For example, purchasing computer systems, determining their tax and other reporting responsibilities, and establishing a relationship with a tax agent may be onerous for these young businesses. Once these systems are in place and routines are established, the burden is generally likely to plateau and possibly diminish slightly over time as business proprietors become more accustomed to the requirements of their business. However, even for older businesses, the perception of the extent of their compliance burden may remain quite high.



Finding 10

Size, turnover and business structure influence the compliance costs of small businesses. New businesses tend to start with low turnover and simple business structures, and generally have lower compliance costs. As the business becomes more successful over time and turnover grows, owners tend to move to more complex business structures, for example companies and trusts, to minimise risk and tax. This can increase both tax and non-tax compliance costs.

Business structure

6.9 While turnover and type of business structure are likely to be related, the research is not so clear on the link between more complex business structures and compliance costs. As noted above, as the size and complexity of a business increases, it is more likely to progress to a more complex business structure with resulting higher regulatory compliance costs. The decision to change to a company structure causes the most significant regulatory cost, due to common law and ASIC requirements.

6.10 Generally, small home-based businesses that are largely sole traders or family-based businesses tend not to feel burdened by regulations. This may be because, like very new businesses, they are 'flying under the radar' and are unaware of regulations, or choose not to comply, or they are largely unaffected by regulatory requirements (such as through having turnover below the GST threshold).

6.11 Nevertheless, as noted in Table 4.1, nearly 700,000 businesses operate as sole traders or companies without employees. These businesses largely represent self-employed business people who have effectively bought themselves a job.

Anecdotal reports suggest that many of these people have shifted from employment to self-employment, and tend to consider any business activity that is beyond that necessary as an employee to be a burden. While obtaining work (for example, submitting tenders and providing quotes) and sourcing supplies are broadly accepted as being part of being in business, at this level of business, keeping records beyond those required to operate a bank account can be considered by some to be a compliance burden.

6.12 Small businesses also commented that as the size of the business increases, the legal protections afforded by incorporation make a company structure more attractive. In addition, a number of small businesses indicated that sometimes it was necessary to incorporate to secure business contracts. This is a compliance burden for small business, albeit not related directly to taxation.

6.13 Nevertheless, because of the legal advantages of incorporation, the possible benefits of a lower corporate tax rate, and the extra business opportunities that incorporation may present, some small businesses may accept the additional compliance burden of incorporation as being a part of growing their business. They may also be in a strong enough financial position to pay tax agents to take on any additional tax compliance burden so that they do not bear the stress or time cost themselves.

Finding 11

Small businesses may not always be fully aware of the tax and non-tax compliance cost implications of establishing their own business and changing from simple to more complex business structures such as a company and/or trust.

EMPLOYMENT OF STAFF

6.14 There was strong consensus among small businesses and tax agents, consistent with other studies, that employment of staff imposes significant regulatory compliance costs. The tax and non-tax issues related to employment that have been identified as an issue for small businesses are listed in Table 6.1 below, classified by the level of government imposing them.

6.15 The more employees a business employs, the greater is the sense of perceived burden. Some businesses may also regard the potential employment compliance burden as a barrier to business growth.

Table 6.1 Employment-related regulations

Type of regulation →	Tax related regulation	Non-tax related
Jurisdiction ↓		
Commonwealth	Employment/TFN declarations PAYG(W) Fringe benefits tax	Superannuation Guarantee Superannuation Choice Workplace relations legislation
State/Territory	Payroll tax	Occupational health and safety Leave entitlements Award entitlements

6.16 Pre-election surveys undertaken by the Australian Chamber of Commerce and Industry (ACCI) support the view that non-tax employment issues can be of more concern to potential voters than tax related employment issues. Table 6.2, derived from the ACCI 2001, 2004 and 2007 surveys, shows the issues of concern to small business in those years.

6.17 The most recent data for 2007 show that changes in legislation in recent years have had an impact on small business perceptions of the issues that concern them. While non-tax employment-related regulations still generally appear to be of concern to more businesses than tax-related employment issues, concerns about unfair dismissals and the Superannuation Guarantee have fallen significantly. Of the taxes causing concern, FBT appears to worry the greatest percentage of small businesses, despite very few small businesses actually paying FBT (see Tables 4.2 and 4.3). Chapter 9 reports on issues related to FBT and small businesses.

Table 6.2: Issues of Concern to Small Business: ACCI Survey Series (per cent of businesses)

Issue	2001	2004	2007
Unfair dismissals	73.6	73	55.8
Workers' compensation	67.9	77	72.7
Superannuation Guarantee	66.0	73	52.5
OH&S obligations	64.8	n/a	54.6
Compliance with GST	64.5	57	51.0
Time to complete BAS	63.1	60	52.0
Fringe benefits tax	62.2	68	63.5

Source: Australian Chamber of Commerce and Industry pre-election surveys 2001, 2004, 2007.

6.18 Small businesses have advised the Board that superannuation and occupational health and safety compliance issues are of particular concern. These issues are outlined in more detail in Chapter 10.

Finding 12

Employment of staff imposes significant regulatory compliance costs, many of which are not tax related.

Some business operators choose not to grow beyond a certain size so that they can avoid additional risk, complexity and administrative burdens.

INDUSTRY

6.19 Recent studies of compliance costs have consistently identified small businesses in the agricultural, construction, mining and retail (with mixed GST and non-GST supply) sectors, and in licence-based industries (such as hotels, the health sector, preschools, cafes, restaurants and real estate agencies) as bearing the most significant regulatory load. In some cases, non-tax regulations appear to contribute most to this burden.

6.20 Small businesses in agricultural industries appear to have particularly heavy regulatory compliance costs, with Atax's interviewees reporting a heavy burden in complying with environmental and development regulations. Unlike tax obligations, it appears that there are limited opportunities for small businesses to engage others to assist them in meeting these obligations.

6.21 Small businesses in the mining industry also appear to have significant regulatory burdens as a result of a combination of employment issues, immigration laws, native title, and inconsistencies between state and local jurisdictions' requirements.

6.22 Acknowledging the burden in the agricultural and mining sectors, the previous Government targeted primary industry as the first industry to be examined by the Productivity Commission in a series of cyclical reviews of Australian Government regulatory burdens on business. The terms of reference for the review were issued to the Productivity Commission by the then Treasurer on 28 February 2007.⁵⁵

6.23 Further, small businesses in the restaurant and catering industry have reported considerable compliance burdens. Many businesses in this sector are very small, and can find dealing with food safety regulations, mixed GST and non-GST supplies and liquor licensing laws particularly challenging.

6.24 Higher regulatory burdens have been reported by small businesses in industries where workplace safety concerns are an issue, such as in manufacturing and construction. Businesses in the construction industry, in particular, have compliance obligations associated with planning and approval processes. These obligations not

55 Terms of reference are at: <http://www.pc.gov.au/regulatoryburdens/primarysector/tor.html>.

only include a significant paperwork load but also time delays and fees that impose significant costs on small businesses.

Finding 13

Industry sector can influence both the level of compliance costs and whether tax or non-tax compliance costs are more significant. Businesses that operate in the construction, restaurant and catering, agricultural and mining industries, in particular, appear to experience significant non-tax regulatory compliance costs.

LOCATION

6.25 Consultations suggest that compliance costs appear to be higher where businesses operate near state borders or otherwise supply goods and services interstate.

6.26 This is at least partly due to inconsistency between the States in relation to employment-related legislation such as occupational health and safety and payroll tax. Differences may also exist between administrative requirements at a local government level, such as zoning laws, which may also affect intrastate trade.

6.27 Businesses in the most populous states (especially NSW and Victoria) are more likely to report administrative burdens than those in the least populous and geographically larger States (especially WA and the NT). This may be because businesses in the larger States need to deal with a greater number of administrative jurisdictions and there may be inconsistencies between their various administrative requirements.

6.28 A recent report by the Business Council of Australia and Corporate Tax Association⁵⁶ noted that of the 56 different taxes imposed on business, 33 of these were at the state and territory level and 2 at the local level. These 35 taxes raised only 17 per cent of total business tax revenue, suggesting that there could be scope to streamline the administrative processes used to collect this revenue. Harmonising taxation regimes across jurisdictions may also assist in identifying areas of taxation that could be streamlined and compliance requirements possibly reduced.

6.29 The Productivity Commission is currently undertaking a benchmarking study of business regulation across all jurisdictions to determine the extent to which there is consistency across the States.⁵⁷ This will be useful for businesses in making decisions

56 Business Council of Australia and Corporate Tax Association, 'Tax Nation: Business Taxes and the Federal-State Divide', April 2007.

57 The study follows a COAG decision in February 2006 to adopt a common framework for benchmarking, measuring and reporting on the regulatory burden on business.

about which jurisdictions are easiest to operate in. It will also indicate areas where regulation could be streamlined and greater consistency achieved.⁵⁸

OVERSEAS TRADE

6.30 Atax reported greater regulatory compliance burdens for businesses that engage in overseas trade.⁵⁹

6.31 Around 49 per cent of the 42,000 businesses that export goods from Australia have turnover of less than \$1 million. However, in terms of the value of exports, these businesses with turnover of less than \$1 million account for only about 1 per cent of the value of all exports. So while many exporters are small businesses, the value of their exports is very small.

6.32 Table 6.3 shows the types of industries engaged in by small business exporters in 2005-06.

6.33 With around 20,000 small businesses involved in exporting, foreign income taxation issues may be of some relevance to small businesses, and these provisions have been identified as a compliance issue with the Board (see Chapter 9).

58 See Council of Australian Governments' Meeting record, 13 April at <http://www.coag.gov.au/meetings/130407/index.htm#mental>.

59 Atax p 28.

Table 6.3: Small exporters of goods and value of exports, 2005-06

	Number of small business exporters	Total number of exporters	Value of small exporters of goods (\$m)	Total value of goods exports
Goods exporters with an ABN				
Agriculture, forestry and fishing	583	1,123	57	1,869
Mining	165	483	18	59,848
Manufacturing	3,840	10,358	298	46,264
Construction	488	1,042	29	328
Wholesale trade	5,189	11,834	442	29,326
Retail trade	2,299	4,205	113	2,201
Transport and storage	478	1,173	53	1,764
Finance and insurance	295	827	25	2,402
Property and business services	2,161	3,886	143	5,039
Other	1,339	2,818	71	2,022
All goods exporters with an ABN	16,837	37,749	1,249	151,063
Goods exporters without an ABN	3,061	3,100	97	1,327
Total goods exporters	19,898	40,849	1,346	152,390

Source: Extracted from ABS cat. no. 5368.0.55.006, 2005-06, table 5A. For this data, small exporters are defined as those with turnover less than \$1 million.

OWNER CHARACTERISTICS

6.34 The Atax study found that age and gender did not appear to affect the extent to which small business proprietors felt stressed by tax compliance costs.⁶⁰ However, tax agents suggested that the skills, attitudes, efficiency and confidence of the small business proprietor were significant determinants of whether they were likely to cope with tax compliance obligations.

6.35 The Atax report noted that business owners who felt comparatively less stressed about tax compliance were those who expressed trust in their accountant or in the adequacy of their own reporting systems. The owner's attitude to the accountant and to book keeping practices would appear to affect the psychological cost of compliance. Business owners who felt that their tax compliance activities were a nuisance rather

⁶⁰ Atax p 28.

than a stressful activity were more likely to be those who did not have employees, a self-managed superannuation fund, cash flow constraints or profitability concerns.⁶¹

Finding 14

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.

COMPUTERISATION AND ACCOUNTING SYSTEMS

6.36 Technological advances and cost reductions have brought computers, internet access and specialised small business accounting packages within the reach of most small businesses in recent years. This was further facilitated by a government subsidy to upgrade computer systems and software that was provided to small businesses as part of the transition to The New Tax System in 2000.

6.37 Evans et al⁶² reported that in 2005, 88 per cent of the businesses they surveyed had at least partially computerised their record keeping systems.

6.38 A major finding of the Atax report was that the extent to which a business has computerised and integrated accounting systems in place influences its tax compliance costs.⁶³ It noted that businesses with well-integrated accounting systems generally did not rate GST or the BAS as an onerous task. It did also note, however, that the cost of setting up and learning how to use an appropriate computer system and software can be significant for a small business, as it tends to be a fixed or stepped cost without reference to turnover. This may contribute to the regressive nature of compliance costs. In this sense, computerisation may cause significant transitional compliance costs, but it does provide scope for reducing ongoing tax compliance costs, as well as easing the burden of non-tax accounting requirements once systems are established.

6.39 The development of software packages that are readily compatible with tax system obligations has been an important factor in making tax compliance easier for those businesses that use computers. However, tax agents noted that further progress can still be made in ensuring that computerised business accounting systems are fully compatible with tax requirements. Tax compliance costs will clearly be lower when business people can collect the information required for tax purposes in the course of their normal business practices. Standard Business Reporting provides the potential to assist businesses in this area.

61 Atax p 28.

62 Evans C, Carlon S, Massey, D, 2005, 'Record Keeping Practices and Tax Compliance of SMEs', *eJournal of Tax Research*, Vol 2 No. 2, p 320.

63 Atax p 27.

Finding 15

Businesses with computerised recording and reporting systems tend to manage their compliance costs better.

EXTERNAL DRIVERS OF COMPLIANCE COSTS

6.40 External drivers of compliance costs are those factors largely outside the control of individual business proprietors that have a significant effect on the compliance burden they face.

Structure of the taxation system

6.41 Australia's increasing integration into the global economy, the growing sophistication of businesses and accounting practices and the broadening policy agenda of government have meant that the Australian taxation system has become increasingly complex over time.

6.42 In developing taxation policy, governments must balance the competing tax axioms of efficiency, equity and simplicity, and the decisions they make have a significant effect on the complexity of the tax system, the design of the legislation used to implement it, and its administration. In addition, the use of the tax system to deliver non-tax policy objectives adds complexity to the system. The financial incentives for businesses to minimise their tax liabilities and maximise their access to concessions can also drive the design of tax policy and administration.⁶⁴

Self assessment

6.43 The introduction of a self assessment system for Commonwealth taxation in 1986 (1989 for companies and superannuation funds) changed the role of the ATO from assessing the taxation liability of taxpayers to assisting taxpayers with compliance with the self assessment system.⁶⁵ Some taxpayers have argued that this shift in emphasis has reduced the finality, and therefore the certainty, of taxpayers' tax affairs. The onus of responsibility for making a tax assessment now belongs to the taxpayer, with significant penalties possible for serious errors (where reasonable care has not been taken).⁶⁶ This responsibility weighs heavily on some small business proprietors,

64 Oliver and Bartley (2005) examine the public and private drivers of tax system complexity and compliance costs in some depth.

65 This is so even though the process for filing a tax return remains largely the same. Under both systems taxpayers provide the facts which give rise to a taxable income amount. A tax rate is then applied to that figure. Indeed the previous system had significantly higher penalties for errors of fact with no threshold of reasonable care.

66 See *Review of Aspects of Income Tax Self Assessment* Discussion Paper, March 2004, p 5.

particularly those with unsophisticated record keeping systems and little understanding of the business tax system.

6.44 The introduction of The New Tax System in 2000 also changed the way small businesses comply with the tax law. New PAYG requirements brought forward the payment of instalments, while GST required the 'classification' of transactions, regular reporting and payments, and enhanced record keeping (tax invoices).

6.45 Some taxpayers perceive the shift in emphasis brought about by self assessment and The New Tax System as constituting a shift in the administrative burden of the taxation system from the government (ATO) to individuals and businesses, many of whom rely on tax professionals to prepare their tax return for them.

6.46 During 2004, Treasury conducted a Review of Aspects of Income Tax Self Assessment. The review focused on identifying whether the income tax laws achieved a fair balance between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole Australian community. The review identified a number of refinements to the system aimed at reducing uncertainty and compliance costs for taxpayers while preserving the ATO's capacity to collect legitimate income tax liabilities. Some of the recommendations of this review have been legislated and administrative changes made by the ATO, while further recommendations are being addressed through additional reviews by Treasury, the Board of Taxation and the Inspector-General of Taxation.⁶⁷

Small business concessions

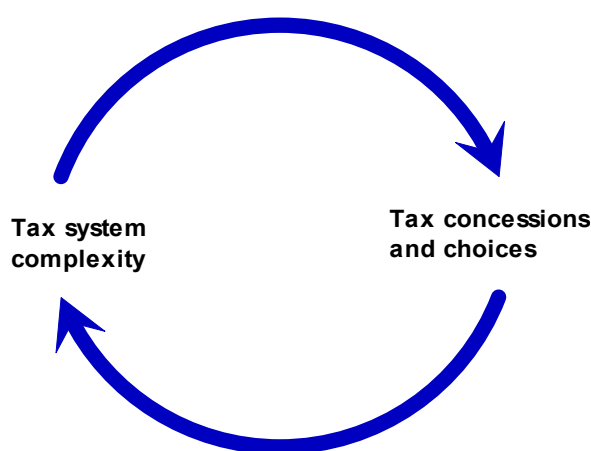
6.47 Some participants in this study suggested that the needs and practices of smaller businesses are not always taken into account in the design and administration of business taxation policies, partly because the diversity of the small business sector makes it more difficult for them to be engaged in consultation processes.

6.48 However, the introduction and ongoing refinement of small business concessions within the tax system in recent decades suggests that small businesses and their advocates have successfully influenced the design of policy. Measures to provide simpler rules, choices, or de minimis thresholds to exclude small businesses from various business taxation requirements reflect the Government's acknowledgement that the tax system, in terms of compliance, is more complex and that tax compliance can be onerous for smaller businesses compared to larger businesses. Table A8.2 in Appendix 8 lists some of the special small business tax concessions currently available. The Small Business Framework, which commenced in 1 July 2007, links many of the small business concessions under a common set of eligibility criteria.

67 For details see the review of income tax self assessment web page at <http://selfassessment.treasury.gov.au/content/default.asp>.

6.49 While separate small business tax concessions have been developed to enable small businesses to avoid the complexity of the broader business tax system, or avoid provisions that do not suit their circumstances, the existence of a separate set of rules, thresholds and methodologies adds to the complexity of the tax system as a whole. More generally, the greater the number of special rules for selected groups in the tax system, the more complex the tax system as a whole becomes. As Figure 6.2 suggests, tax system complexity results in pressure for concessions and special rules for those that have the most difficulty in dealing with complexity. This in turn can result in further tax system complexity. This needs to be acknowledged by all stakeholders in the tax system if this cycle is to be broken.

Figure 6.2: The cycle of complexity and concessions



Choices

6.50 The range of choices and concessions available in the tax system result in many small businesses engaging tax professionals when they might not otherwise, in the hope of maximising their tax concessions and refunds or otherwise structuring their business affairs to reduce their tax liabilities. These become ‘voluntary’ financial tax compliance costs. In some cases taxpayers incur the costs of performing multiple tax calculations to assess eligibility under various options, for little, if any, tax benefit.

6.51 Similarly, while the majority of businesses prepare their own BASs, the growth in the book keeping industry since the introduction of the GST indicates that many businesses are choosing to outsource their BAS preparation. This may be a function of sensible business practice, with business owners choosing to focus on their core business activities and using specialists to fulfil tax and bookkeeping requirements, or it may reflect the level of skill required to navigate the requirements of one or the other, or both.

Inter-governmental relations

6.52 Research and discussions with small businesses and their tax agents indicate that compliance costs are significant for those businesses that have regulatory obligations at all three levels of government and that must also deal with differences in taxation regimes across the States, such as in payroll tax.

6.53 On 29 March 2007, state and territory treasurers announced that they had agreed to simplification and harmonisation of some provisions and definitions for payroll tax, including timing of lodgment, some allowances, a range of fringe benefits, and work performed outside a jurisdiction, to come into effect no later than 1 July 2008.⁶⁸ NSW and Victoria have undertaken further payroll tax alignment, effective from 1 July 2007. However, States and Territories will retain control over individual rates and thresholds, with payroll tax thresholds currently varying between \$504,000 and \$1.25 million per year across the jurisdictions. Small businesses that operate across jurisdictions will still need to be aware of these differences to ensure they comply with their payroll tax obligations.

6.54 While this progress towards achieving consistency in state-based payroll tax laws between jurisdictions is a step in the right direction, there is scope for moving towards greater uniformity of other aspects of payroll tax, such as rates and thresholds. There may also be other areas where greater consistency can be achieved. The benchmarking study being conducted by the Productivity Commission will assist in identifying these areas. The extent to which they are taken up will be a matter for the States and Territories.

Technological improvements

6.55 Technological improvements can affect tax compliance costs both within small businesses and at a broader macro level.

6.56 Technological advances across the economy provide scope to drive business compliance costs down. The pace with which computer technology has transformed taxation administration and business practices over the last decade means that there are now even more opportunities for small businesses to choose ongoing low-cost automation and streamlining of tax and other regulatory compliance activities.

6.57 While the level of computer sophistication of small businesses in Australia has increased substantially in the last decade, there is still a sizeable group of small businesses that do not use information technology effectively in running their business. Among those that do use computer support, the level of comfort in using these systems varies, and many such businesses are too time-poor to use them adequately. It is

68 29 March 2007, Joint Media release – State and Territory Ministers ‘State and Territory Treasurers Agree to Historic Payroll Tax Reform’.

important that these small businesses are carried along in this current wave of technological advancement so that systems are developed that can be readily accessed by all business, regardless of size. Ultimately, small businesses may be able to use software and portal interface products that service their accounting and taxation obligations at the same time, with a compliance burden that is only slightly higher than that necessary for regular business operations.

6.58 Standard Business Reporting, announced by the then Treasurer in August 2007, provides some prospects for using technological advances and improved cooperation between the state and federal tax jurisdictions to assist businesses in meeting their reporting obligations. The aim of this project is to reduce reporting burdens for business through eliminating unnecessary or duplicated reporting, and improving the interface between business and government. There is also further scope for the ATO to work with software providers on the development of business software that is well integrated with tax reporting requirements. Box 6.1 provides details on Standard Business Reporting.

Box 6.1: Standard Business Reporting Programme

On 30 August 2007 the then Treasurer announced the Standard Business Reporting Programme. Developed in response to Recommendation 6.3 of the Banks Report, Standard Business Reporting (SBR) is a whole-of-government initiative to benefit the Australian business community by simplifying the way it reports to government.

Financial reporting is the first group of forms to be targeted because these affect the broadest section of the business community. This includes the BAS, Company Income Tax Returns, Tax File Number Declarations and the Quarterly Business Indicators Survey.

The Treasury will coordinate the programme that involves the Australian Bureau of Statistics, the Australian Prudential Regulation Authority, the Australian Securities and Investments Commission, the Australian Taxation Office and, potentially, State Revenue Offices, to work together to deliver the improvements to financial reporting for SBR.

SBR will make financial reporting easier for business by:

- removing unnecessary or duplicated reporting;
- standardising terminology used in reporting;
- developing technology to allow businesses to send their financial reports to SBR agencies via a single security sign-on; and
- working with software companies to develop products that will allow government forms to be pre-filled directly from business accounting/record-keeping software.

Box 6.1: Standard Business Reporting Programme (continued)

SBR will utilise eXtensible Business Reporting Language (XBRL), a standard developed by the accounting sector for financial reporting expressly to extract reporting information from accounts. A similar initiative to SBR has been implemented successfully in the Netherlands for financial reporting, and other countries are also considering similar approaches.

SBR will be hosting an international conference in late November 2007 for members of the accounting and software industries to find out more about SBR and XBRL. At the conference, delegates will be able to learn from international experience and establish networks.

The full implementation of SBR for financial reporting is scheduled for mid-2010. There will be earlier implementations in 2008-09 of TFN Declaration Forms as well as other pilots and tests to gain confidence and support for the new processes and systems. Members of the accounting and software industries will be invited to work with the SBR agencies and to get ready early.

CHAPTER 7: DEALING WITH TAX AND OTHER COMPLIANCE COSTS

7.1 Small businesses can face a wide range of regulatory obligations. The extent to which these obligations result in compliance costs for the business owner and the nature of these compliance costs (financial or psychological and temporal) depend not only on the nature of their business, but also on the way in which they choose to deal with these regulatory obligations. Businesses may perform all their compliance obligations themselves, seek assistance from family and friends or pay others to perform those obligations (in whole or part) for them.

7.2 Businesses tend to choose the way in which they bear compliance costs based on three main factors: the size of the business; their cash flow/profitability; and the extent to which they are risk-averse. The choices they make about how they deal with compliance costs tend to affect their perceptions about the extent of the cost. In particular, outsourcing compliance obligations to paid service providers can reduce psychological and temporal compliance costs and perhaps the perception of compliance costs, while increasing the financial costs. Actual compliance costs may remain the same, with a shift in the nature of those costs.

OUTSOURCING TAX COMPLIANCE ACTIVITIES

7.3 Australians are highly reliant on external advisers in fulfilling their tax and accounting compliance obligations, with over 90 per cent of business returns being lodged by tax agents since the late 1980s. This compares with 80 per cent of New Zealand businesses.⁶⁹ That most Australians use tax agents is not indicative of a problem per se. It may be a reflection of rational choices about comparative advantage and the opportunity costs of time. Outsourcing of a variety of services is also an increasing trend in Australian society which has seen the growth in range of services like gardening, home maintenance, cleaning and home shopping.

7.4 What may be of more concern is if the complexity of the taxation system and additional tax obligations is resulting in an increase in the cost of the services provided by tax agents.

69 Atax p 14.

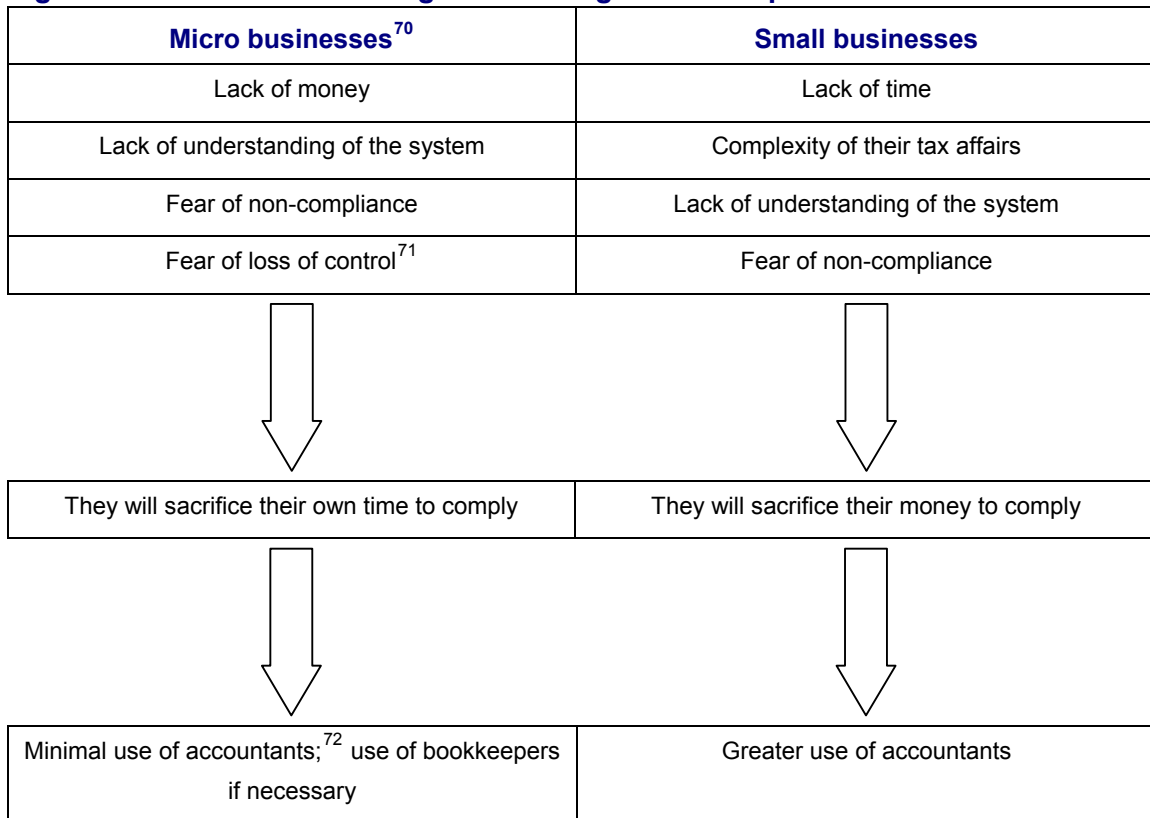
7.5 Research undertaken by Atax and discussions with small businesses and tax professionals suggest that the size and sophistication of the business heavily influence the extent to which small businesses outsource their tax compliance requirements.

7.6 It seems that fear of non-compliance with the tax law and a lack of understanding of their tax requirements are the key triggers that prompt small businesses to use tax professionals. Lack of understanding may also lead to a fear of missing out on concessions or opportunities to which they might be entitled. Figure 7.1 maps out the key factors influencing the decision of micro and slightly larger businesses to outsource compliance activities.

7.7 Cash-flow/profit appears to be the limiting factor that determines the degree to which the micro-businesses will broker out these activities to tax professionals. If the business proprietors are financially constrained, and this constraint is larger than their fear of making errors, then they will undertake these compliance activities themselves. The compliance cost would be borne in terms of their time, and they would (often resentfully) accept working long hours on their book work in order to comply with requirements and keep control of their business. When compliance activities are brokered out, it may often be family and friends who are called upon to provide bookkeeping assistance or advice, although small businesses are also making use of bookkeepers for a fee. Accountants may be called on for advice relating to non-tax compliance concerns such occupational health and safety and ASIC requirements, which they cannot manage themselves, and currently for the lodgment of some BAS.

7.8 However, for slightly larger or more complex businesses, cash flow/profit becomes less of an issue and time becomes a more important factor. These business proprietors are willing to outsource their tax compliance more readily, not only because they have more money and more complex affairs (that is, have a higher risk of errors), but also because they want to spend their time on the core business.

Figure 7.1: Factors influencing outsourcing of tax compliance



Finding 16

A significant number of small businesses outsource their tax compliance obligations, particularly to tax agents and bookkeepers. Key factors determining whether businesses outsource their tax compliance obligations include the size and complexity of the business, the cash flow, the proprietor’s understanding of their record keeping and reporting obligations, and the prioritisation of their time.

ROLE OF TAX AGENTS

7.9 Tax agents play a significant role in the tax compliance of small businesses. There are just over 22,000 registered tax agents in Australia and collectively they lodge over 95 per cent of tax returns for small businesses. Many agents also provide financial advice and/or act as independent auditors of self-managed superannuation funds.⁷³

70 Micro businesses refer to those with turnover under \$2 million per annum, while small businesses in this example refers to businesses that have turnover between around \$2 million and \$5 million per annum.
 71 CPA Australia (2005) Small Business Survey Program – Outsourcing, May, p 11.
 72 Except for annual returns.
 73 ATO, 2006-07 Compliance Program, p 73.

Box 7.1: A profile of the tax agents industry

ATO data analysis indicates that there were 22,030 active⁷⁴ tax agent registrations as at 28 June 2007. Overall there has been a 1.8 per cent growth in the number of active registrations since 2003. Demographic data shows that the tax agent profession:

- is ageing, with 40 per cent of tax agents 55 years or older;
- is mostly male, with only around 20 per cent of tax agents being females (despite around 44 per cent of accountants being females)⁷⁵; and
- has a client base consisting of mainly small business.

In addition there are around 10,000 accountancy practices in Australia, with most providing taxation services.⁷⁶

Research conducted by the ATO in 2007⁷⁷ indicates that:

- the average working week for tax agents has significantly decreased from 49.1 hours in 2005 to 43.8 hours in 2007. There have also been significant decreases in the proportion working 51-60 hours per week (from 26 per cent in 2005 to 21 per cent in 2007) and the proportion working more than 60 hours per week (from 9 per cent in 2005 to 5 per cent in 2007);
 - However, 61 per cent still consider they are working very or somewhat excessive hours.
- most tax practices offered business planning/recovery services, software services and financial planning, including superannuation;
- while 54 per cent of tax agents were optimistic about the future of the tax profession, (a significant increase from 39 per cent in 2003), the major issues facing the tax profession were:
 - complexity of and continual change to tax legislation;
 - regulatory compliance/tax administration burden; and
 - the ability to recruit and retain quality staff;

74 Active is defined as having clients, or being a new agent registration. Note that numbers of tax agents do not necessarily correspond with the numbers of tax agent *registrations*. Numbers of registrations exceed the number of natural persons registered.

75 Although this may change as a similar gender ratio to accountancy is appearing in tax agent age groups under 35 years.

76 ABS, 2003.

77 ATO, 2007, TNS Social Research, State of the Industry Research.

Box 7.1: A profile of the tax agents industry (continued)

- 73 per cent of tax agents were satisfied with their job as a tax practitioner, significantly higher than 40 per cent in 2003;
- 7 per cent of tax agents indicated an intention to leave, and 19 per cent to retire within the next 2 to 3 years. While the intentions indicated in the 2005 research did not translate into declining registrations, this situation will need to be monitored given the age demographics of the active tax agent population;
- 73 per cent of accountants new to public practice⁷⁸ were optimistic about the future of the accounting industry, and 79 per cent were satisfied with their job as an accountant; and
- 49 per cent of accountants new to public practice indicated that if they left their current position, they would go on to work for another accounting firm, and 24 per cent had a long-term goal of starting their own tax practice.

7.10 Discussions with tax agents suggest that the growing complexity of the tax system, the pace of change to tax legislation and extrinsic materials, higher demand for their services, and recruitment difficulties due to a tight labour market and the repetitive nature of the work, have placed the tax professional industry under significant pressure in recent years.

7.11 Consequently the structure of the tax agent industry is reportedly gradually changing. The shortage of experienced staff in the industry is said to be contributing to significant takeover activity by medium businesses of smaller businesses to acquire those staff who have broad accounting experience. This is having consequences for small businesses, who are finding that there are now fewer of the smaller, less expensive tax agent firms available to undertake their detailed small business accounting work. This is particularly an issue in regional areas where there is limited choice of tax agents. As a result of the shortage of experienced small tax agents, more small businesses may be relying on bookkeepers to keep their accounting expenses down. At the same time, some tax agents are concerned about the loss of business opportunities that may arise from the growth of the bookkeeping industry.

Role of bookkeepers

7.12 Bookkeepers undertake bookkeeping functions for businesses, either internally or externally to the firm. They generally provide a lower cost option for small businesses than tax agents.

78 These accountants are employees of tax practices and obtained their accounting degree five or less years ago.

7.13 Since the introduction of The New Tax System, the bookkeeping industry has grown significantly, largely due to the significant role played by bookkeepers in the preparation of BASs. ABS data indicate that there were 130,800 bookkeepers in Australia in February 2007, compared to 108,400 in February 2000.⁷⁹

7.14 A 1996 Yellow Pages survey reported that 28 per cent of small businesses used the services of an internal bookkeeper. This proportion rose as the number of employees and the turnover of the business increased. Evans et al reported that 76 per cent of the financial records of small businesses were maintained in-house, with a further 9 per cent using the services of an external bookkeeper.⁸⁰

7.15 Under subsection 251L(6) of the ITAA 1936, bookkeepers can receive a fee for the provision of a BAS service if they are a member of a recognised professional association (RPA – as defined under the Act) or under the direction of a registered tax agent.⁸¹ The ATO estimates that around 10 to 15 per cent of bookkeepers prepare and lodge BASs on behalf of clients.

7.16 The quality of the service provided by bookkeepers can vary, but unlike tax agents, they are not directly regulated. According to the ATO, around 35 per cent of bookkeepers have no formal qualifications and more than 40 per cent have no formal training. The Australian Association of Professional Bookkeepers has noted that the 2002-03 Auditor-General's report found that more than 27 per cent of the 9.7 million business activity statements contained errors.⁸²

7.17 The ATO works closely with bookkeepers, their industry representatives and professional accounting associations to support the role bookkeepers play in the tax system.⁸³ However, some tax agents have suggested that issues may still arise in ensuring that all parties are protected, including clients. Those tax agents commented that they feel vulnerable because of the possible errors, for which they are liable, caused by bookkeepers preparing BASs under their supervision.

7.18 High standards of bookkeeping will reduce the risk to taxpayers who use bookkeeping services and the registered tax agents who direct the providers of BAS services.

7.19 The exposure Bill and Regulations for the planned new tax practitioner regime (see Box 7.2) will widen the scope of the regulatory framework to incorporate BAS

79 ABS Labour force Survey, Australia –DEWR trend data, cited at <http://jobsearch.gov.au>.

80 Yellow Pages (1996) and Evans et al (2005) quoted in Atax p 15.

81 As well as those providing payroll services and customs broking.

82 Quoted in 'Number crunchers count cost of errors', *The Age*, 1 September 2006.

83 The ATO has established a Bookkeeper Advisory Group to provide input into the design of administrative interactions between bookkeepers and the ATO. See *ATO Compliance Program 2007-08* p 62.

service providers.⁸⁴ It proposes to regulate those persons who are in the business of providing BAS services, but not regulate bookkeepers in general. Under the exposure draft Bill, an entity (including a bookkeeper) will be required to register if they are providing, or propose to provide, any service for a fee that relates to advising, ascertaining or satisfying the liabilities, obligations or entitlements of an entity under a BAS provision, provided in circumstances where it can reasonably be expected to be relied upon. BAS service providers will have access to assistance from the Tax Practitioners Board, from the RPAs and from educational institutions to increase their knowledge of the tax laws and obtain ongoing professional education and support. They will also be subject to the requirements of the Code of Professional Conduct and associated sanctions for breaches.

Box 7.2 The New Tax Practitioner Regulatory Framework

On 9 May 2006 the then Minister for Revenue and Assistant Treasurer announced that the Government would provide funding for implementation of a new national legislative framework for tax practitioners.

The new regime will:

- establish a national Tax Practitioners Board, to replace the existing state Tax Agents' Boards;
- create a code of practice (the 'Code of Professional Conduct') to govern the provision of tax practitioner services;
- allow a more flexible approach to regulating tax practitioners through a wider range of disciplinary sanctions; and
- provide for a safe harbour from tax shortfall penalties for false and misleading statements for taxpayers where they engage a registered tax agent to prepare their return and take reasonable care to provide that person with all of the information necessary to complete it.

The new regime will also provide for the registration of Business Activity Statement (BAS) service providers and enable the registration of certain types of tax specialists.

'A national framework will ensure consistency in the registration and regulation of tax practitioners', the Minister said. The new funding will enable the streamlining of registration and regulation processes, and provide better and more flexible regulation through access to a greater range of sanctions plus an enhanced ability to undertake proactive regulatory work. In addition, the new funding to the ATO will allow it to provide tailored services to a wider range of tax practitioners. Together, these initiatives should ensure that tax practitioner services are high quality and accessible and that taxpayers who use tax practitioners have greater certainty and appropriate protection.

Source: Minister for Revenue and Assistant Treasurer Press Release 016, 2006.

84 Minister for Revenue and Assistant Treasurer's press release 2006/16 at <http://assistant.treasurer.gov.au/pcd/content/pressreleases/2006/016.asp>.

CHAPTER 8: TAX COMPLIANCE COSTS: RECURRING ISSUES AND THEMES

8.1 In conducting the scoping study, the Board identified several key issues and themes that consistently emerged out of discussions with small businesses and tax professionals. These issues and themes do not necessarily point to specific changes to the tax law that might reduce compliance costs. Rather, the Board believes that if all stakeholders have regard to the matters outlined in this Chapter in considering future changes to the small business tax system, compliance costs are likely to be reduced over time. These issues and themes focus more on the process of change and considerations associated with making change, rather than the changes themselves. These themes are also relevant to State and Territory governments and local councils.

8.2 While several of the previous Government's initiatives in response to the Banks report (and announcements made in other contexts) have begun to address the concerns identified through the course of this study, there is still scope for further work to be done to identify and address small business tax compliance concerns.

8.3 It would be almost impossible to design an ideal small business tax regime that would satisfy all the tax axioms and the Government's revenue requirements. Trade-offs will be necessary between competing policy objectives. The choices that governments, generally in consultation with stakeholders, make when designing a tax measure or system will have different compliance cost impacts. In making future changes to the small business tax system, all stakeholders need to acknowledge trade-offs in tax design.

8.4 The trade-offs that have become most apparent through the course of this study are as follows:

- Choices and options for taxpayers, concessions, and carve-outs create complexity in the tax system. Transitional arrangements arising from changes can also increase complexity. Greater simplicity could be achieved by fewer options and more limited transitional arrangements, but this may result in some taxpayers being worse off as a result of the change.
- In some cases, costs can be borne either by business as compliance costs, or by the Government as administration costs, or shared.
- Certainty in the tax law can create complexity when a range of instances and circumstances are spelt out in black-letter law and supporting extrinsic materials.

However, complexity might also result from the provision of additional extrinsic materials that may be necessary to support principles-based drafting.

- Change to the tax system creates transitional compliance costs, but changes for the better are necessary to improve the tax system and, once the changes bed down, ongoing compliance costs will be lower. Continual change, however, results in ongoing transitional compliance costs.
- The benefits of individual changes to the tax system may outweigh the direct compliance costs associated with those changes, however the cumulative burden of individual changes can add to tax system complexity.

VARIATIONS IN DEFINITIONS AND THRESHOLDS

8.5 One of the most frequent concerns raised with the Board by small businesses and their agents was that many definitions of what constitutes a 'small business' are used for a variety of purposes. As noted in Chapter 4, even within Commonwealth legislation, variations exist. Annual turnover, number of employees, asset value, the nature of control over operations, the extent of market power, the business structure and financing options or a combination of these attributes have all been used to define a small business in Commonwealth legislation.

8.6 Variations in definitions for concessions and thresholds across taxes add considerably to business compliance costs as businesses and their agents spend time either checking eligibility or trying to become eligible for small business concessions and other benefits. In some cases, the complexity of eligibility tests means that some businesses do not even bother trying to determine eligibility and may miss out on benefits because of the high cost of compliance.

8.7 The introduction of the new Small Business Framework from 1 July 2007 reflects the previous Government's acknowledgement that a standard definition and threshold for small business, at least within the Commonwealth taxation system, may help to reduce compliance costs for small businesses. Under the Small Business Framework, a single small business eligibility test – turnover under \$2 million – now determines eligibility for a range of small business concessions, replacing a range of other thresholds.

8.8 However, this definition is not used uniformly across Commonwealth legislation and recent proposed and actual changes in other areas of the law have used differing definitions. For example, for collective bargaining notification purposes under the *Trade Practices Act 1974*, a standard definition for small businesses of \$3 million applied from 27 March 2007, but businesses in four different industries have thresholds

ranging from \$5 million up to \$20 million.⁸⁵ Under WorkChoices legislation, employers with less than 100 employees cannot be subject to unfair dismissal claims.

8.9 There are other examples where different definitions are used across all layers of government regulation. An example that was referred to in consultation was the different definitions of employee for income tax, superannuation, payroll tax and work cover purposes. Wages and salaries are also defined differently for different purposes.

8.10 While it is acknowledged that different definitions may be required to achieve a range of policy objectives, compliance costs could be reduced if in developing new provisions regard was had to existing definitions as much as possible. There may also be merit in developing core definitions with variations being made by way of adding in or taking out.

Finding 17

Some progress has been made in standardising the definition of 'small business' in tax law, but different definitions are still used in other parts of the law, making it difficult to define clearly the boundaries of the small business sector. There would be merit in exploring the broader application of a standard definition across all legislation.

Finding 18

Inconsistent definitions and thresholds for concepts such as 'employee' and 'salary and wages' cause complexity in the law and uncertainty for small businesses, potentially adding to their compliance costs.

Thresholds

8.11 In addition to differing definitions, there are a variety of thresholds in the tax system that are relevant to small businesses, including 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 record keeping 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.

8.12 Some thresholds affecting small businesses have been adjusted in recent months. In the 2007-08 Budget the previous Government increased the business turnover

85 Joint Press release, Treasurer and Minister for Small Business and Tourism, 'High Collective Bargaining Thresholds for Small Business' 2007/15, 27 March 2007.

threshold above which businesses must register for GST from \$50,000 per year to \$75,000 per year, effective 1 July 2007. Likewise, the threshold above which businesses must require a receipt to claim input tax credits was lifted from \$50 to \$75, also effective 1 July 2007.

8.13 Some submissions and other commentators have called for a systemic approach to adjusting all thresholds in the tax law. This issue was also referred to the Board as part of this study by Recommendation 5.48 of the Banks report.

8.14 The level of thresholds is ultimately a policy judgment and the income, turnover and value of thresholds applied to each tax measure need to be considered in the policy context of that particular measure, the broader policy objectives, and the full budgetary context. A system-wide regulated approach to the adjustment of tax thresholds may not necessarily be consistent with any of these objectives and could build in taxpayer expectations and undermine the Government's policy flexibility. It is important, however, that thresholds are regularly reviewed to ensure that they are continuing to meet their policy objective.

MULTIPLE LEVELS OF COMPLIANCE OBLIGATIONS

8.15 Linked to the difficulties involved in inconsistent definitions are problems that can arise through inconsistencies and/or duplications in laws between the various jurisdictions within the federal system of government. Most taxes, including income tax and GST, are collected by the Commonwealth Government (although GST revenue is passed from the Commonwealth to the States and Territories), land and payroll tax are generally collected by the relevant State/Territory government, and rates are charged locally. In addition, a range of other regulatory obligations such as employment and planning issues apply at different levels of government. As a result businesses have to deal with a range of administrative bodies at different levels of government and varying criteria in relation to their regulatory obligations.

8.16 Businesses that operate across a broad geographical range and that are involved in highly regulated industries such as cafes and restaurants, construction and agriculture, often deal with regulation at all three levels of government.

8.17 The Board agrees with the comments expressed by ACCI to the Banks Taskforce and Australian Business Limited to the NSW Regulation Red Tape Review:

The problem is not so much with any individual tax, but the cumulative effect of many individual taxes imposed on businesses.⁸⁶

(A)ccumulation of regulation—rather than individual pieces—is the most significant issue for business.⁸⁷

8.18 Initiatives have recently been introduced to try to improve consistency in reporting standards and requirements, with a view to reducing the compliance burden on all taxpayers (see Box 6.1 – Standard Business Reporting). Similar processes in other countries, the Netherlands in particular, have resulted in significant compliance cost savings. In addition, in the 2007-08 Budget the previous Government announced the Australian Business Number (ABN) Business Names Registration Project which aims to reduce compliance costs associated with registering for an ABN and a business name.⁸⁸ Around 600,000 ABNs and 250,000 business names are registered each year.

Finding 19

Businesses that have to comply with regulations imposed by several jurisdictions because they operate across state and territory borders experience higher regulatory compliance costs than those that operate within one State or Territory. Trading across national borders is likely to increase compliance costs further, with nearly half of all Australian exporters being small businesses.

IMPACT OF BROADER POLICY OBJECTIVES

8.19 At its core, the taxation system is a mechanism for collecting revenue to fund public expenditure. As noted, the objective of the tax system should be to raise revenue in the most efficient, equitable and simple way possible. The tax system can also on occasion be used as a delivery mechanism to achieve other non-tax policy objectives. In particular, the tax system can be used as a mechanism for income redistribution including through welfare payments, industry assistance and philanthropy. Measures that offer multiple choices, carve-outs, concessions for sectoral groups and definitional inconsistencies may also reflect broader policy objectives.

8.20 Using the tax system to achieve these broader policy objectives can make it difficult to balance the efficiency, equity and simplicity of the tax system. In particular,

86 Australian Chamber of Commerce and Industry, 2004, page xi, quoted in Banks report p 111.

87 Australian Business Limited submission to NSW RR IPART, February 2006, p 1.

88 This project is in response to Banks report recommendation 6.4. See Department of Industry, Tourism and Resources fact sheet at http://www.industry.gov.au/assets/documents/itrinternet/fact_sheet_5.

it can lead to increases in compliance costs including as a result of taxpayers working through eligibility for multiple concessions to optimise their tax outcomes.

8.21 In consequence, while steps have been taken to reduce specific small businesses tax compliance burdens incrementally, the complexity of the overall tax system may increase when the tax system is used as a delivery mechanism for non-tax policy.

8.22 One submission to this study noted the range of tax offsets now available, including those for mature age workers and small entrepreneurs, dependent spouses, and private health insurance. Government payments available through the tax system include the new maternity allowance, the old baby bonus and family tax benefit. While many of these are not directly relevant to small business, they do impact on the business operator's perception of complexity. Perhaps partly in acknowledgement of the impacts of the complexity of the tax system, the previous Government announced in the 2007-08 Budget that the child care tax rebate would in future be paid directly through the Family Assistance Office rather than through the tax system.

Finding 20

Use of the tax system to achieve social and other broader policy objectives can increase the complexity and pace of change of the law. This can influence perceptions of compliance costs and may in some cases increase actual compliance costs.

Choice

8.23 The provision of a range of options for taxpayers, including small business taxpayers, and the desire at times for no-one to be worse off following changes to the tax law, can increase the complexity of the tax system and add to compliance costs as taxpayers may evaluate options to determine which minimises their tax liability. However, the fact that options and choices are provided in the tax system is likely in part to be as a result of the desire of taxpayers for these options and choices. This may be particularly the case where there has been consultation in the development of measures. Taxpayers may not be fully aware of the implications of these options and choices for the complexity of the tax system and compliance costs. Nonetheless, the apparent desire for options and choices (with accompanying complexity) by taxpayers generally (where it reduces tax liability) can limit the opportunities for governments to simplify laws, particularly where not all taxpayers will benefit from a more simplified approach.

8.24 The Banks report suggested that the Government should focus on achieving a low-rate, broad-based tax system that would improve economic efficiency and reduce compliance costs. However, this would involve businesses having to accept significantly fewer concessions and exemptions from the general tax regime, in exchange for a simpler system with lower compliance costs, but with the potential for

some to be worse off as a result of the change in the short term.⁸⁹ This is one of the trade-offs that needs to be acknowledged by all stakeholders in the tax system.

Finding 21

The provision of a range of choices, concessions and thresholds for small business in the tax system adds to complexity and encourages small businesses to seek professional advice which increases their financial compliance costs.

AMOUNT OF TAX LAW AND EXPLANATORY MATERIAL

8.25 The amount of tax legislation that Australian taxpayers and tax professionals have to comply with increases every year. The creation of new operative tax legislation continues every parliamentary sitting period. As noted in the Office of Parliamentary Counsel's 2005-06 annual report, 'taxation legislation continues to be an area of substantial demand' for legislative drafting services.⁹⁰ In 2005-06, 74 income tax measures were enacted, contained within 20 tax Bills. This comprised over 900 pages of amending legislation.⁹¹ This growth in tax legislation is not unique to Australia – in the UK, the number of pages of tax legislation has more than doubled from around 3,700 to 8,300 in the last 10 years.⁹²

8.26 In September 2006 the previous Government repealed 4,100 of pages of inoperative provisions of tax legislation⁹³ (and amended or deleted around 200 related public rulings). Tax agents have indicated that, while a welcome reduction in the bulk of the tax law, it has had limited practical impact on them apart from reducing the time spent on electronic searches. Tax agents have indicated that of more concern to them is the complexity of the remaining operative provisions.

8.27 While the significant amount of tax law and its growth is an issue in itself, keeping up with the range of rulings, tax determinations, interpretive decisions and practice statements to assist small business and their advisers increases the compliance burden for tax agents significantly. However, these ancillary products are often sought by small businesses and their advisers in an attempt to obtain greater certainty about the application of the tax law to their circumstances. This desire for certainty can be at

89 A similar theme emerged from the Ralph Review of Business Taxation 1999, 'A Tax System Redesigned'.

90 Office of Parliamentary Counsel Annual Report 2005-06, p 3.

91 This figure excludes excise and fuel tax bills. Source: Office of Parliamentary Counsel.

92 Pricewaterhouse Coopers/The World Bank 'Paying Taxes – the Global Picture' p 16. A study by Pricewaterhouse Coopers in July 2006 examined the burden of federal tax administration for the top 20 countries ranked by gross domestic product, using the number of pages of primary federal tax legislation as a proxy for the tax burden. They found that while Australia was ranked as the 13th largest economy in terms of GDP, it ranked third out of the 20 in terms of the number of pages of primary legislation (7,750), after India (9,000) and the United Kingdom (8,300).

93 Treasurer's press release 2006/64 at <http://www.treasurer.gov.au/tsr/content/pressreleases/2006/064.asp>.

odds with efforts to simplify and generalise the tax law through, for example, principles-based drafting approaches⁹⁴, and standardised definitions, eligibility criteria and thresholds.

8.28 In particular, submissions to this review noted that a shift towards a more principles-based approach to drafting tax legislation led to an increase in the number of rulings being sought, in an attempt to provide further certainty for taxpayers. However, principles-based drafting approaches are not intended to reduce the certainty of the tax law and there are differing views on the extent to which further guidance will be required.

8.29 Submissions also indicated that the rationalisation of the 1936 and 1997 income tax assessment Acts into a single Act would assist in simplifying the tax law. The recent Simpler Superannuation reforms are a good example of cut-through, innovative policy reforms that have achieved significant simplification of complex legislation.

Finding 22

Achieving both certainty and simplicity is a key challenge for all participants in the tax system. While taxpayers' desire for certainty from the tax system is being met by the ATO offering to tax agents a range of public and private rulings, determinations, practice statements and other supporting materials, these can increase the overall complexity of the system.

ONGOING CHANGE

8.30 It is not just the volume of tax legislation that increases complexity and compliance costs, but also the ongoing change to the law. As noted by CPA Australia:

Tax agents nominated tax law complexity coupled with the continual changes to tax legislation as the most critical elements of the compliance burden faced by themselves and their clients.⁹⁵

8.31 Every time the Government changes the tax law affecting small businesses, these businesses or their tax agents bear an additional compliance burden as they are required to investigate the potential impacts on their businesses and tax practices. Taxpayers and tax agents have to become aware of and understand these changes, training of staff may be required and systems and software programmes may need to be modified. Transitional compliance costs of changes are likely to be significantly higher than ongoing compliance costs once changes have bedded down. Small

94 See Pinder, G ,2005, 'The coherent principles approach to tax law design', *Economic Roundup*, Autumn, pp 75-90.

95 CPA submission to the Banks report, page 14, quoted in Banks p 110.

businesses with limited resources are less able to cope well with these ongoing changes.

8.32 The introduction of The New Tax System in 2000 resulted in significant changes to the way that small business taxpayers meet their tax liabilities and interact with the ATO. Compliance costs increased significantly as small businesses and their tax agents were required to learn new systems and methodologies. However, the most significant changes were considered to be short-term *transitional* costs that would diminish as the new systems bedded down and taxpayers and their tax agents became accustomed to the requirements. Most have adapted to different operating requirements, including by increasing their use of computer technology.

8.33 In response to ongoing consultation with businesses about the growing complexity of the business tax system and the extent of the compliance costs imposed, the previous Government made a range of changes to that system for small businesses. The changes to the BAS reporting requirements in February 2001 and the introduction of the Simplified Taxation System (STS) in 2002, followed by further changes to the STS in 2003 and its abolition and replacement in 2007, are among the changes cited by small businesses and their tax agents as increasing their tax compliance burden. This is despite the fact that the changes were being made to assist taxpayers, and often requested by tax agents and small business.

8.34 Changes to the tax law affecting businesses have been announced in almost every Budget since 2000. Some tax agents noted that they did not even consider investigating the STS for their clients because its introduction occurred while they and many of their clients were still coming to grips with the GST and BAS. This suggests that careful consideration needs to be given to the timing of changes, having regard to other changes that are being made at the same time.

8.35 The Government, small businesses and their tax agents face a dilemma. While changes to the business tax system were made in response to concerns from businesses about compliance costs, those very changes are resulting in businesses experiencing further ongoing transitional compliance costs. Until the business tax system is able to 'bed down', continuing transitional compliance costs will continue to make it difficult to identify the extent of *ongoing* compliance costs.

8.36 When making changes to taxation law, governments should be satisfied that on balance and over time, the benefits of the proposed changes will significantly exceed the ongoing compliance burdens imposed on taxpayers by the changes. In addition, governments should also consider the efficiency aspects of proposed changes to the tax system in relation to the business needs of taxpayers. Changes that accord as closely as possible with the convenience of taxpayers, and their existing business systems, will minimise compliance costs.

Finding 23

Change to the tax system can increase compliance costs as both taxpayers and tax agents seek to understand new arrangements. However, change is also necessary to address concerns about compliance costs. Mandatory compliance cost assessments will assist in determining whether particular changes will increase or reduce compliance costs.

While individual changes may be justified, they need to be considered in the context of other changes that are being made. The cumulative impact of all changes on compliance costs also needs to be considered.

IMPACT ON THE TAX AGENT INDUSTRY

8.37 As noted in Chapter 7, small business taxpayers rely heavily on tax agents to meet their compliance obligations whenever they can afford to and the perceived benefits outweigh the costs. In recent years, particularly following the introduction of The New Tax System, it appears that there has been an increasing demand for the services of tax agents. While the number of taxpayers using tax agents has remained fairly stable over that time, the nature of the services sought from tax agents may have expanded. This increased demand, coupled with the steady flow of new and amending legislation, rulings, determinations, interpretations and practice statements (most requested by tax agents), make keeping on top of the law difficult for tax agents.

8.38 In addition, while the demand for tax agents' services is increasing, the current tight labour market means that the industry is having difficulty in attracting new skilled entrants, and the tax agent industry is ageing.⁹⁶ Some tax agents are concerned that a crisis will emerge within the next decade if action is not taken either to reduce demand for tax agent services or increase the supply of tax agents. The proposed new Tax Practitioner Regulatory Framework for tax agent services (which includes BAS services) may facilitate a better division of labour between tax agents and BAS service providers by seeking to improve the quality of BAS services.

8.39 Other tax agents have responded to the issue of complexity by referring more complex matters to specialist firms. However, this may increase the costs to their clients.

8.40 The training of tax agents is also an area of concern. Experienced tax agents report that many young staff recruited to the industry do not have sufficient pre-existing knowledge of the taxation system, as many of them have not undertaken

96 Accountants were included on the 'migrant occupations in demand' list as at 30 July 2007 (Department of Immigration and Citizenship website – <http://www.immi.gov.au/skilled/general-skilled-migration/skilled-occupations/occupations-in-demand.htm>.)

taxation-specific subjects at tertiary level. As a result, the vast majority of taxation knowledge is learned on the job.

Finding 24

The complexity of the tax system and recruitment difficulties are placing significant pressure on the tax agent industry.

APPLICABILITY OF MEASURES TO SMALL BUSINESS

8.41 Several of the instances of high compliance costs for small businesses cited by tax agents arise from situations where the small businesses have attempted to use tax measures that may not have been specifically designed for small business. Tax agents suggest that in some of these cases the then Government did not clearly indicate whether these tax measures were intended to apply to small businesses. When small businesses are not the intended users of a measure, but they still access the measure, their compliance costs may be disproportionately high.

8.42 Examples given by tax agents include the demergers legislation, the consolidations regime and the company tax losses provisions. It is reportedly difficult for small businesses to use these provisions and details on the difficulties involved are contained in Chapter 9. Moreover, the demerger provisions are often seen by small businesses as a means of facilitating intergenerational transfers of business assets, a purpose for which the provisions were not necessarily designed.

8.43 In some cases it may be the Government's intention that certain provisions not be available to small business. If this is the intention, then it should be made clear in the legislation and explanatory materials, rather than small businesses and their tax professionals discovering that certain provisions are not small business-friendly through resource-intensive trial and error.

Consultation processes

8.44 An ongoing effective programme of community consultation on the development of tax legislation (supported by post-implementation reviews when appropriate) is important in ensuring that tax legislation is well designed and implemented. Small businesses have expressed concern that they are not being consulted sufficiently or consistently about changes to the tax system affecting them before the changes are made. The Board of Taxation in its report on *'Government Consultation with the*

Community on the Development of Taxation Legislation' (March 2002)⁹⁷ outlined the following key principles for consultation:

- a commitment by the Government to consult on all substantive tax legislation initiatives, except in exceptional circumstances only;
- a clear explanation of the policy intent of each new tax initiative, and a description of the proposed consultation processes for each initiative;
- an approach of seeking the most effective forms of community input at each phase of the tax design process, including:
 - before any public announcement, obtaining input from external technical experts to assist high-level policy development and to identify implementation options;
 - after the public announcement, further input from external technical experts, combined with sectoral and broader community consultation as appropriate; and
 - 'road-testing' of legislation and related products before implementation;
- clear accountability for developing and implementing legislation that delivers the Government's policy intent;
- open communication and appropriate levels of feedback; and
- sufficient resources of time, personnel and finances being provided for consultation.

8.45 The previous Government broadly accepted the Board's recommendations and from 2002 onwards worked from an in-principle position on consultation that is consistent with the Board's recommendations.

8.46 More recently, in its report to the previous Treasurer 'Improving Australia's Tax Consultation System', the Board of Taxation recommended further minor improvements to the tax consultation process. The report, prepared in conjunction with Treasury, noted that since 2002 there have been significant improvements in tax consultation arrangements and they are now consistent with international practice, are generally functioning well and have community support.⁹⁸

97 A copy of this report is on the Board of Taxation website at <http://www.taxboard.gov.au/content/review.asptacboard.gov.au>.

98 Board of Taxation 2007, 'Improving Australia's Tax Consultation System – A Report to the Treasurer', February, at http://www.taxboard.gov.au/content/improving_tax_consultation/index.asp#Report.

8.47 The recommendations outlined in the report are for evolutionary change to the tax consultation system, within the broad framework of the existing arrangements developed in response to the Board's 2002 report. In particular, the report noted the difficulties of including small businesses in consultation processes and recommended⁹⁹ that 'governments, officials and external stakeholders should seek improved engagement with sectors currently under-represented in consultations, including considering mechanisms for assistance with resourcing issues wherever possible'.

8.48 On 15 August 2007 the previous Treasurer announced that the Government had endorsed the recommendations made in the report on ways in which government, officials, external stakeholders and the Board itself can work together to improve Australia's tax consultation system.¹⁰⁰

8.49 The Government (including through Treasury) should continue to build and maintain direct relationships through consultation and review so that it can gain a deep understanding of how taxpayers are impacted by the tax system-in-use, enabling it to take a holistic approach to change to the tax system.¹⁰¹ The Board of Taxation has an ongoing role in monitoring tax consultation processes.

Finding 25

Consultation with small business is important to ensure that the design of tax policy, legislation, administrative systems and supporting materials suits the needs of small business.

SMALL BUSINESS TAXPAYER EDUCATION

8.50 Taxpayer education and assistance is particularly important for small businesses as they have limited resources to devote to tax compliance activities. There was a perception among some of the small businesses consulted by the Board that there had been a decline in the extensive tax education services provided to small business owners and tax agents in the lead-up to and immediately following the introduction of The New Tax System. They believed that newer businesses had fewer opportunities to learn the skills that would help them to become more confident about their tax responsibilities and reduce their compliance costs.

8.51 However, the ATO has continued to provide a range of tax education services (see Chapter 5) and it appears that lack of awareness or interest in these services (given

99 In recommendation 5 of the report.

100 See the Treasurer's press release in response to the Board of Taxation report: 'Improving Australia's Tax Consultation System: Report by the Board of Taxation' 2007/07 at www.treasurer.gov.au/tsr/content/prtessreleases/2007/076.asp.

101 Principles for effective tax consultation were announced by the Treasurer on 2 May 2002 in press release 022/2002, 'Reforms to Community Consultation Processes and Agency Accountabilities in Tax Design'.

other priorities), rather than a lack of services, is the key issue. There may also be some reluctance to seek assistance from the administrator of the tax system.

8.52 Each year the ATO conducts hundreds of free tax seminars for small business people in capital cities and regional areas to provide them with information on small business tax issues and obligations. The ATO works closely with local councils, small business groups, industry associations and tax practitioner groups to promote and deliver the seminar programme. In addition, all new business entrants (who do not use an agent) are contacted by the ATO and offered assistance. Co-branding with other organisations may assist in reducing any reluctance to engage with the ATO.

8.53 The ATO also provides a variety of education and information services to the tax practitioners, such as face-to-face presentations, print products, on-line services, and the tax agents' portal. The tax agents who met with the Board were aware of these services and were generally satisfied with them.

8.54 In the 2007-08 Budget the previous Government announced further funding to the ATO to support new businesses with their tax compliance responsibilities. The New Business Intensive Assistance Programme will enable the ATO to conduct more face-to-face visits and more telephone communication with new businesses, assisting them to understand their GST and other record keeping obligations and to develop good record keeping practices.¹⁰²

8.55 One of the key challenges remains communicating to small business the availability of support services and encouraging its use of these services. The Government's website business.gov.au provides details of Commonwealth Government information and services for small business. While this website has received an average of around 280,000 hits per month, and the Office of Small Business has worked cooperatively with other Australian Government departments on the dissemination of information to small business, a perception still remains that the Government is not doing enough to assist small business. Equally, however, small businesses have a responsibility to seek out the support services that they need to assist them in meeting their tax compliance obligations.

8.56 In addition, taxpayer education is not the sole responsibility of the ATO. There is also a role for the tax profession, education service providers and, in some cases, tax agents. The Board's discussions with tax agents suggested that they have differing views of their role, with some seeing it as relieving their clients of as many of their tax obligations as possible, while others regarded their role as facilitative, assisting their clients with compliance activities, including by educating them. Some firms also provide advisory services to other tax agents to assist them on more technical or specialised issues. Externally provided education may also provide a mechanism for engaging with small businesses that are reluctant to deal with the ATO.

102 Budget Measures 2007-08, p 306. See also Treasurer's press release 038/2007.

Finding 26

Education of taxpayers and tax agents can assist in reducing tax compliance costs. There are roles for the ATO, the tax profession and other private sector organisations in providing education, and small businesses themselves need to seek out those services that best meet their needs.

CHAPTER 9: KEY TAX COMPLIANCE CONCERNS

9.1 Of the regulatory requirements imposed on businesses, taxation is generally regarded as imposing the greatest burden on non-employing small businesses. While the extent of the burden varies considerably, taxation compliance is a concern for many small businesses largely because of the known possible consequences of making mistakes.

9.2 However, when asked to be more specific about what particular aspects of the tax system make it burdensome, small businesses were less clear about the answer. For some, it may be the fact that they pay tax rather than the compliance costs of doing so that is the concern. In fact, in gathering information for this study from small businesses and their tax agents, no single aspect of the tax system stood out as being the clear, single precise cause of tax compliance concerns for all small businesses.

9.3 As a result, no simple ready-made solutions have emerged that would cut through the complexity of the tax system and reduce compliance costs. Rather, a more measured approach needs to be taken to small business taxation issues, with full account being taken of compliance cost impacts along the way.

Finding 27

There is no single, precise aspect of the tax system that appears to be driving the tax compliance concerns perceived by small businesses. Rather, changes to and the accumulation of regulation at all levels of government appear to be the problem. Consequently, there is no simple 'quick fix', and improvements are only likely to be achieved through concerted effort by governments across jurisdictions.

9.4 While there was no single aspect of the tax system that contributed to compliance costs, there were a number of specific areas that appear to be more compliance-intensive than others. This chapter outlines some of the key areas identified as causing the most significant tax compliance costs.

BUSINESS ACTIVITY STATEMENTS

9.5 While the completion of BASs is seen as an annoying and time consuming tax compliance burden for small businesses, anecdotal reports suggest that the extent of the burden appears to be gradually decreasing over time, and the degree of the burden varies from business to business.

9.6 The BAS has generally not been a popular reporting tool since its introduction as part of The New Tax System in July 2000. Following significant concerns expressed by small business advocates after its introduction, and based on consultation over the experience of lodging two quarterly returns, the previous Government announced changes in February 2001 aimed at reducing small business BAS requirements.¹⁰³ These changes enabled small businesses to make GST payments on the basis of estimates and lodge an annual statement in some cases. However, the relatively low take-up by small businesses of these simplification measures may have reflected in part their preference to obtain input tax credits for cash flow purposes on a regular basis through lodgment of BASs.

9.7 Notwithstanding the changes, CPA Australia found in its 2003 survey that 37 per cent of the 700 small businesses surveyed said that they were having trouble with the BAS, and 25 per cent with the annual taxation return.¹⁰⁴ Likewise, in its first Red Tape Register survey in 2003, the NSW State Chamber of Commerce found that the quarterly GST return and the BAS was the most time consuming tax requirement for all small businesses, with a third of businesses spending up to 60 hours a year on GST compliance, (equivalent to \$1300 a year).¹⁰⁵ However, part of this would likely be attributable to normal record keeping and accounting for sales and the like.

9.8 The November 2006 ATO Business Perceptions Survey suggests that a significant proportion of micro-businesses – around 15 per cent – still find the BAS process ‘hard’, while around 54 per cent find it ‘easy’. These proportions are relatively unchanged from February 2001.¹⁰⁶ The number of new businesses facing BAS compliance for the first time in each survey period may be underpinning the ‘hard’ result.

9.9 The regularity of BAS obligations and the significant number of new businesses entering the system mean that the BAS is still top of the list in terms of concerns. MYOB’s regular business survey, for example, consistently identifies BAS statements as the greatest source of red tape for small businesses, with over two-thirds of respondents placing BAS reporting in their top three ‘red tape’ issues in January 2007 (followed by GST and occupational health and safety).¹⁰⁷ The consequences of errors in the BAS may contribute to the perceptions of compliance burden. Where small businesses mischaracterise supplies as ‘GST free’ and pass on all or part of the tax

103 Treasurer’s press release 2001/007 ‘Streamlining GST and PAYG Reporting’.

104 CPA Australia, Small Business Survey – Compliance burden, April 2003.

105 Australian Business Limited, incorporating the State Chamber of Commerce (NSW), submission, NSW Regulation Review to Independent Pricing and Regulatory Tribunal of New South Wales, February 2006, p 1.

106 Australian Taxation Office Business Perceptions Survey, wave 10, November 2006 (Eureka Strategic Research).

107 MYOB Australian Small Business Survey Special Focus Report: Red Tape compliance Burden January 2007. There may be some response bias given that BAS, GST and OH&S are the top three on the list of ‘red tape’ choices in the survey.

payable to customers, they risk the repayment of the tax which they cannot readily claw back from their customers.

9.10 For those businesses having difficulty with BAS compliance, the time and stress involved in preparing the BAS generally appeared to be the greatest issues. Smaller businesses tend to try to complete the BAS themselves, but errors are commonplace, and taxpayers become very concerned about the possible penalty consequences of reporting mistakes on items that they do not fully understand.¹⁰⁸ The CPA submission identified 10 common mistakes made by small businesses in completing their BAS forms, which they consider reflect GST complexities and small business issues.¹⁰⁹

9.11 Atax found that around half of the businesses they surveyed relied on an external accountant to complete their BAS.¹¹⁰ For these businesses, the burden became financial, with an associated opportunity benefit for the business operator in terms of time available for the business. Atax reported that the businesses they surveyed paid an average of \$500 per quarter for BAS preparation.

9.12 The approach of tax professionals to BAS compliance varied. While some businesses completed their clients' BAS from source data, others completed the forms without checking data, and another group taught their clients how to complete the forms themselves.

9.13 The extent of the burden imposed by the BAS appears to vary depending on the features of the business. For example, Atax reported that the burden was minimal for those businesses that used computer-based accounting systems as part of their normal business practice. This may reflect, in part, ATO efforts to integrate accounting software with tax and other reporting requirements so as to improve the alignment of ATO requirements with sound business practices.

9.14 The burden of BASs appears to be decreasing over time for those small businesses that are becoming accustomed to the system. The NSW State Chamber of Commerce second Red Tape Register in 2004 showed a significant improvement in the time taken to complete the quarterly BAS since 2003, with 54 per cent of respondents able to complete the statement in less than 5 hours, compared to 44 per cent in 2003.

9.15 Some ATO data tell a similar story. They report that while an average micro-business took around 4.2 hours to complete the quarterly BAS in 2003-04, in 2005-06 it took, on average, 3.6 hours.

108 However, culpability penalties do not apply for honest mistakes where reasonable care is taken. There may also be confusion also as to the difference between penalties and interest on late or under payments, with small businesses and tax agents sometimes not making a distinction between the two.

109 CPA submission p 25.

110 Atax p 25. The January 2007 MYOB survey found 27 per cent used a tax professional to lodge their BAS.

Table 9.1: Average time to complete quarterly BAS by annual turnover (hours)

Turnover	Income Year		
	2003-04	2004-05	2005-06
Under \$50,000	2.5	1.8	2.0
\$50,000 to \$999,000	4.8	4.2	4.2
\$1 mil to \$1.99 mil	4.7	4.4	4.1
\$2 mil to \$9.99 mil	5.0	4.4	4.2

Source: Australian Taxation Office.

9.16 Some businesses also find completion of the BAS is beneficial as it provides a discipline on the business owner to keep a running check on the health of their business.

9.17 Nevertheless, the burden of BAS reporting remains significant for many businesses and it appears particularly to impact on the smaller, newer businesses that are unfamiliar with requirements and have less sophisticated data management systems.

9.18 The Banks report suggested that the provision of additional information on activity statements could assist users, and recommended that the Board identify any possible benefits of this. The Board’s consultations did not reveal any need for additional information on the BAS. In fact, some were concerned with the amount of detail already on the BAS. The Board understands that the Banks recommendation referred to the possible adoption for the BAS of systems used by the Australian Bureau of Statistics that involve the inclusion of useful information alongside each box to assist in its completion. This is then detached from the form prior to lodgment. The ATO may wish to investigate the merits of this system for the BAS.

9.19 A greater concern for small businesses appeared to be their belief that they are not able to submit a BAS online. However, once registered for the ATO business portal, small business operators can lodge activity statements online and receive instant confirmation that this has been successful. The perception that this service is unavailable to small businesses may indicate that there is scope to improve the ATO systems used to disseminate this information.

Finding 28

While concerns about completing Business Activity Statements (BAS) appear to be gradually decreasing over time as businesses become familiar with the requirements, the BAS is still regarded as the most annoying and time consuming tax compliance requirement for small businesses. The degree of the burden varies from business to business. Ongoing education of small businesses about BAS requirements is likely to assist in easing the compliance burden.

SMALL BUSINESS TAX CONCESSIONS

9.20 The Simplified Taxation System, which commenced on 1 July 2001 (and ceased on 30 June 2007), was designed to reduce the tax compliance burden of eligible small businesses. The system provided an alternative method of determining taxable income for businesses with STS average turnover of less than \$1 million that held less than \$3 million in total of adjustable values of depreciating assets. Eligible businesses were required to elect into the system to be entitled to the benefits, which included immediate write-off for assets costing less than \$1,000, more generous, simpler depreciation for many assets, not being required to do an annual stocktake in certain circumstances, and an immediate deduction for business expenses paid up to 12 months in advance.

9.21 Discussions with tax agents suggested that many of their small business clients were unaware of the existence of the STS, and it was tax agents that made decisions about whether small businesses elected into the system. In many cases, those small businesses that were aware of its existence did not feel capable of determining whether the STS would benefit their business.

9.22 In consultations for this study, tax agents were not generally supportive of the STS. Their general comments were as follows:

- The initial STS requirement (until 2005) for businesses to use cash accounting was inconvenient and unpopular because tax agents were more accustomed to accrual accounting and some of their clients preferred up-front deductions for expenses that are incurred but not yet paid.¹¹¹
- Some tax agents perceived the benefits were too modest and only useful for small businesses that could benefit from accelerated depreciation.
- When it was introduced in 2002 many tax agents were still getting across the relatively new GST, so tax agents did not have the time to consider its merits.
- It was an all-or-nothing package and while some elements may have benefited particular small businesses, others may not.
- The various criteria and thresholds for entry increased compliance costs.

9.23 These concerns were reflected in a lower-than-expected take up rate for the STS.

9.24 The Small Business Framework, introduced on 1 July 2007, replaced the STS with a more generous system that enables businesses to choose the benefits that suit their

¹¹¹ Initially, STS users were required to use cash accounting, which would have limited STS take-up. In 2005 the previous Government removed the cash accounting requirement for STS, enabling businesses to choose either cash or accruals.

circumstances. However, the introduction of a range of options within the new Small Business Framework means that tax agents will have to assess the benefits of each component, possibly increasing compliance costs. The take-up rate of the Small Business Framework should be monitored over time to assess the effectiveness of the provisions. A post-implementation review of the regime in two to three years time may be useful.

GOODS AND SERVICES TAX

9.25 The GST was introduced in 2000 as part of The New Tax System to replace the wholesale sales tax and a range of state and territory taxes.¹¹² While the tax is administered by the Commonwealth Government, all GST revenues are distributed to the States and Territories.

9.26 Feedback on the compliance issues with the GST suggests that while the transitional compliance costs associated with the introduction of the tax in 2000 were significant, many businesses are now more accustomed to the tax and accept that the record keeping discipline it imposes assists in the general running of their business.

9.27 While GST is a tax on consumption, it is imposed on the business making the taxable supply. Businesses claim input tax credits for creditable acquisitions. There is some resentment among small businesses that they regard themselves as de-facto tax collectors for the government (employers collecting and remitting PAYG-Withholding seems to cause much less concern).

9.28 The main issues that were identified as compliance costs concerns for the GST were as follows:

- Exemptions and concessions and the classification of goods into GST/GST free/input taxed/capital items are confusing and time consuming. There can be fear of mischaracterising a supply and having to repay amounts that have been passed on to consumers. This is an issue in primary industry in particular, where each invoice must be examined to determine a sale's status for GST. Auctions are reportedly especially complex because it is difficult to know the GST treatment of the transaction until the purchaser is identified.
- The requirement to receive and retain invoices for five years creates storage issues for businesses and costs for those tax agents who can spend a lot of time tracking them down.

112 The States and Territories are still progressing the abolition of the 10 taxes agreed as part of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*. For details see Appendix E of Budget Paper No. 3, *Federal Financial Relations 2007-08*.

- The not-for-profit sector, comprising around 700,000 micro and volunteer based organisations, can have significant compliance costs associated with GST. While the sector receives GST concessions, compliance with the regime is reportedly difficult, at least partly because of the regular use of untrained volunteers for administration.

INCOME TAX

9.29 As a small business grows, so too does the extent of income tax complexity and the need for the business to draw on the expertise of a tax professional to comply with income tax requirements. Over 95 per cent of small business income tax returns in Australia are lodged by tax professionals, with the perception being that the process of preparing annual accounts and lodgment of returns requires the specialist knowledge and services of a tax professional.

9.30 Constant change was cited as the biggest contributor to complexity and compliance costs, with tax agents suggesting that the Government may have on occasion not devoted sufficient time to the development of changes to income tax, with 'legislation by announcement' causing particular concern.

9.31 Tax agents also noted that long lead times between the announcement of a measure and the final legislation, particularly in the period before the final details of the legislation are known, including the date of effect, can create uncertainty and increase compliance costs. However, this is sometimes as a result of consultation in the development of legislation. Without this consultation, there can be issues or problems with the legislation that can take some time to resolve. It is generally better to get the legislation right the first time and consultation assists in achieving this.

CAPITAL GAINS TAX

9.32 The Board of Taxation undertook a post-implementation review of the small business capital gains tax concessions contained in Division 152 of the *Income Tax Assessment Act 1997* during 2005. Twenty-five of the 26 recommended legislative changes in that review were accepted by the then Government, and amendments to the legislation to give effect to those changes were contained in *Tax Laws Amendment (2006 Measure No. 7) Act 2007*, which received Royal Assent on 12 April 2007.

9.33 The changes were made to improve the operation of the small business CGT concessions by replacing the controlling individual 50 per cent test with a significant individual 20 per cent test, and changing the maximum net asset value test, the active asset test, the 15-year exemption, the retirement exemption, the small business roll-over, and how the concessions were to apply to partnerships. The changes apply

from the 2006-07 income year and were designed to reduce compliance costs and increase availability of the concessions.

9.34 The small business CGT concessions should also be more accessible following the introduction of the New Small Business Framework in July 2007.

9.35 However, the recent changes do not alter some of the fundamental aspects of CGT that make it a difficult tax for some small businesses. Unlike most other taxes, CGT is often a 'one off' tax paid in unusual circumstances that are not normally a part of core small business operations. Small businesses and their tax agents are sometimes unsure whether they have triggered one of the many CGT events or rollovers or not. CGT is also particularly relevant to intergenerational transfers for small business.

9.36 While there have been many changes to the CGT since its introduction in 1985, there has not been a systemic review of the provisions. As a result, the provisions have become more complex over time and there may be opportunities to reduce compliance costs significantly in this area.

Finding 29

While changes have been made recently to improve the operation of the small business capital gains tax concessions, the complexities of capital gains tax legislation still make it difficult for small businesses to comply easily.

FRINGE BENEFITS TAX

9.37 Very few small businesses pay FBT (see Tables 4.2 and 4.3) and the Atax study found that small businesses did not appear to have significant compliance cost issues in respect of FBT. Their research supported the New Zealand experience, (as reported by Colmar Brunton), that businesses are more likely to provide fringe benefits as the number of employees increases.¹¹³

9.38 Atax suggested that small businesses either do not believe they have FBT obligations or take a pragmatic approach and implement systems to limit exposure to the tax by cashing out benefits. However, those who choose to avoid FBT by seeking employee contributions still face compliance costs associated with determining the size of the employee contribution necessary to avoid FBT liability. For that reason, some tax agents believe that the small business compliance costs for FBT are larger than they appear, particularly given the small amount of FBT payable by the small business sector. This view is consistent with a recent finding of the 2007 ACCI pre-election survey that FBT caused more concerns to small businesses than any other single Commonwealth tax (see Table 6.2).

113 Atax p 28.

9.39 Several submissions and focus group participants noted some particular aspects of the FBT rules that imposed significant compliance costs on small business employers.

FBT year

9.40 The difference between the income tax year (commencing 1 July) and FBT reporting year (commencing 1 April) was an issue raised in discussions with small businesses and tax agents. While some businesses saw the lack of consistency of reporting period as an additional compliance burden because they had to pay their tax agent to undertake additional work at a different time of year, many tax agents viewed it as beneficial because it enabled them to spread their workload. Others found the differences annoying but were reluctant to suggest change because they considered the transitional costs of making the change could exceed the minor benefits of alignment.

Business meals

9.41 One submission claimed that the current taxation treatment of business meals allows for 39 different treatments of a meal, and that this imposes significant compliance costs on the restaurant and catering industry.¹¹⁴ In addition, they believed that the FBT discriminates against small business because of the differential tax treatment of meals on and off business premises. The submission also noted that the detailed record keeping requirements, covering the types of food consumed, also impose a proportionately heavier burden on smaller businesses.

9.42 In the *Compliance Program 2007-08*, the ATO acknowledges that some businesses are having difficulty in applying the correct fringe benefits tax treatment for meal entertainment and it advises that during 2007-08 they will issue information to assist taxpayers with their tax obligations in relation to meal entertainment.¹¹⁵

Car parking

9.43 Several small businesses noted that the rules relating to on-premises car parking are difficult to determine (especially rules about value) and attribute to individuals and that the cost of collecting the information required to claim an exemption can be significant. Small businesses that have an income of less than \$10 million are exempt from FBT for car parking that is not provided in a commercial car park. Some argued that simplification is necessary to reduce compliance costs associated with providing car parking in a commercial car park. Use of simpler methods of calculating a reasonably accurate value of the benefit were also considered beneficial.

114 Restaurant and Catering Australia submission, p 5.

115 *ATO Compliance Program 2007-08* p 32.

9.44 The Banks taskforce proposed a review of the FBT treatment of car parking. The then Government considered that a standard valuation method for car parking would add to compliance costs and would raise equity issues, but was prepared to consider any suggestions to reduce car parking compliance costs where the valuation methods proposed would result in a reasonable approximation of the cost of the benefit provided.

Minor and infrequent benefits

9.45 Submissions also called for an increase in the minor benefits threshold from \$100 and clarification of the meaning of irregular and infrequent benefits to improve certainty and reduce compliance costs. Both of these suggestions were also made by the Banks taskforce and were accepted by the then Government. The minor benefit threshold was increased to 'less than \$300' effective 1 April 2007. The ATO has also reviewed its guidelines on minor benefits and has provided clarification through a public ruling about what is considered 'irregular' and 'infrequent' for the purposes of the minor benefits exemption. The final ruling TR 2007/12 was issued on 19 December 2007.

Finding 30

While very few small businesses pay fringe benefits tax, some small businesses undertake considerable compliance activities in order to avoid being included in the FBT system.

PAY-AS-YOU-GO WITHHOLDING

9.46 While the Board was asked to consider ways of reducing the number of PAYG withholding tables as a part of Recommendation 5.48 of the Banks report, it has not found that the number of PAYG withholding tables is a significant contributor to compliance costs for small businesses or tax professionals. Few small businesses, tax agents or submissions commented on PAYG withholding as part of this study. The general view was that while there are many tax withholding schedules, once employers are aware of the appropriate table for their employees then there is little need to be concerned with the other tables.

9.47 The existence of a large number of withholding schedules reflects the differential treatment of various classes of taxpayers, for example residents versus non-residents; employment in various industries such as defence; and the inclusion of various benefits and allowances in the tax system. While this largely reflects policy decisions by government, it also again indicates the extent to which tax system complexity is increased by the use of the tax system to provide benefits to certain groups of society.

TRUST LOSS PROVISIONS AND FAMILY TRUST ELECTIONS

9.48 Recommendation 5.48 of the Banks report identified trust loss provisions and family trust elections as an area of the tax law that should be examined in the Board's study as a potential source of unnecessary complexity and compliance costs.

9.49 The trust loss measures in Schedule 2F to the ITAA 1936 are designed to prevent the tax benefits that arise from the recoupment of trust losses and debt deductions being transferred to persons who do not bear the economic effect of the loss when it was incurred. The trust loss measures achieve this by imposing a number of tests that must be met before losses and debt deductions can be claimed. Broadly, the tests examine whether there has been a change in underlying ownership or control of a trust or whether certain schemes have been entered into in order to take advantage of losses or debt deductions. Different tests apply to different types of trusts. An exemption from the specific tests applies for certain family trusts.

9.50 To qualify as a family trust, an eligible trust must make a family trust election. A family trust may utilise tax losses without the requirement to meet the more onerous tests for loss recoupment in the trust loss regime. Beneficiaries of family trusts are also allowed to access franking credits under the 45 day holding rule.

9.51 Certain trusts or partnerships are able to make an interposed entity election which allows the entity to be included as part of the family group of the individual specified in a family trust election. Distributions outside the family group are subject to a penalty rate of taxation at 46.5 per cent. This gives the entity concessionary treatment under the trust loss provisions. Both of these elections have been generally irrevocable.

9.52 In submissions and discussions held as part of this study, stakeholders indicated that the narrowness of the exemption and the inability to revoke a family trust election caused significant compliance costs. They suggested that ideally, the complex trust loss provisions should be removed because they are not necessary, or at least, the Government could remove anomalies that cause unnecessary compliance costs. The most difficulties appeared to arise because of the inability to revoke a family trust election and inflexibility in defining a family group.

9.53 Following representations from taxpayer representative groups, the previous Government announced in the 2006-07 Budget that it would increase flexibility in the family trust provisions by enabling family trust elections and interposed entity elections to be revoked or varied in certain limited circumstances. The definition of a family group was broadened also to include lineal descendants of family group members. In addition, trust distributions to former spouses and to widows or widowers of family group members with new spouses were also exempted from family trust distribution tax. Legislation to give effect to these reforms, contained in *Tax Laws Amendment (2007 Measures No. 4) Act 2007* received Royal Assent on 24 September 2007.

DIVISION 7A — NON-COMMERCIAL LOANS

9.54 Several tax agents reported that there were significant compliance cost issues in relation to the integrity rules for distributions by private companies contained in Division 7A of the ITAA 1936.

9.55 The purpose of Division 7A is to prevent private companies from making tax free distributions of profits to shareholders or their associates. At present if a private company makes an advance, loan or other credit to shareholders, and it is not specifically excluded from Division 7A, then it is treated as a deemed dividend. In this situation, the private company's franking account is debited (up until 1 July 2006) and the deemed dividend is taxable in the hands of the shareholder, but without access to a franking credit to offset the tax paid by the company.

9.56 The application of Division 7A appears to have been widely misunderstood by taxpayers and their advisers, resulting in inadvertent and frequent breaches of the provisions, particularly for small businesses. The ATO acknowledged the need to lift awareness of the rules among businesses and their tax agents in its *Compliance Program 2005-06*.¹¹⁶

9.57 In submissions and discussions tax professionals have argued that these provisions are overly harsh and that small businesses can unintentionally be caught by them with serious taxation consequences. While to a large extent their concerns relate to government policy rather than compliance costs, the acknowledgement by the ATO that there would be significant benefits in improving taxpayer understanding of these provisions should assist taxpayers in avoiding unintentional capture by these rules.

9.58 Representations from the accounting profession to the previous Government resulted in an announcement on 6 December 2006 by the then Minister for Revenue and Assistant Treasurer of changes to the Division 7A provisions aimed at reducing the punitive nature of the law, providing the Tax Commissioner with a discretion to disregard deemed dividends in certain circumstances, and reducing compliance costs by providing greater flexibility and certainty for taxpayers.¹¹⁷ The Tax Commissioner's discretion provides taxpayers with an opportunity to correct honest mistakes or inadvertent omissions in relation to Division 7A made between 2001-02 and 2006-07.¹¹⁸ The changes to Division 7A were contained in *Tax Laws Amendment (2007 Measures No. 3) Act 2007* which received Royal Assent on 21 June 2007.

116 ATO *Compliance Program 2005-06* p 33.

117 Minister for Revenue and Assistant Treasurer press release 2006/89, 'Amendments to the tax law to reduce compliance costs for small business', 6 December 2006.

118 See ATO media release 2007/37 'One-off opportunity for business following changes to Division 7A', 30 July 2007.

DEMERGERS

9.59 In essence, a 'demerger' involves restructuring a corporate or trust group by splitting it into two or more entities or groups, with the underlying owners holding one or more of those entities or groups directly. The tax demerger provisions provide CGT rollover relief on the splitting of an entity into smaller parts, subject to conditions.

9.60 The demerger provisions are found in Division 125 of the ITAA 1997 and have applied since 1 July 2002.

9.61 While the demerger provisions were largely intended for medium or large businesses, small businesses are using the provisions to assist in family succession planning. As the demerger provisions were intended to be used to improve business efficiency, many family dealings have difficulty in coming within the terms of the provisions. In doing so, small businesses must self assess their eligibility for demerger CGT rollover relief, while ensuring that they do not breach section 45D which relates to dividend streaming. Tax agents feel obliged to apply for a ruling to gain assurance that there is no breach of section 45D, but they claim that this is a long and time consuming process.

9.62 Tax agents have expressed concern that there are significant compliance costs involved in seeking and obtaining a ruling under section 45D. They claim that much of the problem relates to the failure to acknowledge, at the time of policy and legislative design, that small businesses might access these provisions, and the circumstances where this was so and where it would not be so. The demerger provisions are an example of a measure where the object and scope could have been more clearly articulated in the law.

Intergenerational transfers/succession planning

9.63 Small businesses and their advisers engage in a variety of measures under the tax law to facilitate intergenerational transfers of assets in a tax effective manner. Demergers and CGT laws, in particular, are used for the purpose of intergenerational asset transfers, although they were not specifically designed for this purpose. A more coherent set of rules around intergenerational change, including a better fit between federal, state and territory initiatives in this area, may reduce the costs of succession planning advice.

Finding 31

Many small businesses are experiencing significant tax compliance costs in attempting to manage intergenerational transfer of business assets. The lack of a comprehensive regime to deal with succession planning issues across all levels of government appears to contribute to these costs.

FOREIGN CURRENCY GAINS AND LOSSES

9.64 As almost half of Australian businesses that export are small businesses, (see Chapter 6) taxation arrangements of foreign exchange are of interest to some small businesses.

9.65 In discussions with tax agents and in submissions, participants have expressed concern that the current regime is overly complex and imposes high compliance costs on small businesses and their agents.

9.66 Currently, businesses can ignore foreign currency gains and losses from certain foreign denominated bank accounts if the total balance does not exceed the foreign currency equivalent of \$250,000. Following industry consultation, changes to the legislation were announced¹¹⁹ (but are not yet legislated) that will broaden the types of accounts that these funds can be held in. However, participants consider that the \$250,000 threshold is too low, even though the vast majority of small businesses have turnover below \$250,000 (see Chart 4.1). One submission argued that the possible interaction of this legislation with capital gains tax provisions creates unnecessary complexity for taxpayers and their agents.

9.67 The Government could consider these issues in more depth in the development of possible new legislation covering foreign currency gains and losses.

EMPLOYER-CONTRACTOR ISSUES

9.68 The distinction between contractors and employees is an issue for some small businesses, particularly those in the construction, IT, film and fishing industries. Atax noted that employers tended either to accept the contractor's status at face value, or treat all workers as employees. Atax also noted, however, that while legislation has been introduced to address this issue, as it retains the common law test for determining whether a person is a contractor, it is unlikely to assist in alleviating the existing confusion.¹²⁰

119 Minister for Revenue and Assistant Treasurer press release 5 August 2004.

120 Atax p 45.

9.69 One submission¹²¹ noted that there remains a common misconception that employees in possession of an ABN were automatically a contractor rather than an employee. While the ATO has developed written material to assist businesses in making the distinction, such as the building and construction worker decision making tool, confusion apparently remains and there is scope to improve education on these issues. More importantly, consideration could be given to whether the different tests that apply under the common law, the income tax Acts, the Superannuation Guarantee Charge and WorkCover could be harmonised. This would require legislative change.

121 CPA p 10.

CHAPTER 10: KEY NON-TAX COMPLIANCE CONCERNS

RELATIVE IMPORTANCE OF NON-TAX COMPLIANCE COSTS

10.1 There does not appear to be a strong community consensus on how significant tax compliance costs are compared with other broader issues for small businesses.

10.2 Table 10.1 shows the relative importance of tax compliance as an issue for small businesses in the 2007 ACCI pre-election survey.

Table 10.1: ACCI pre election survey 2007 — single most important factor by size of business

Single most important	Small business	Medium business	Large business
Economic management	26.2	23.6	24.8
Complying with tax system	9.2	4.8	5.7
Level of taxation	20.5	21.0	7.8
Workplace relations	14.1	17.3	20.6
Skills development	12.9	12.5	18.4
Government regulation	8.6	8.8	8.5
Infrastructure	8.6	11.9	14.2

Source: ACCI 2007 Pre-election Surveys No. 1, June 2007.

10.3 The ACCI data suggest that other areas of the economy are a higher priority than tax and other regulatory requirements for small businesses, although not surprisingly, small businesses rate tax compliance as a greater concern than larger businesses do. Nevertheless, tax compliance does rate as a slightly more significant concern for small businesses than 'government regulation' more generally.

10.4 However, it is not clear whether costs inherent in running a business, such as accounting costs, are included in the small business perception of 'compliance costs'. In addition, as indicated elsewhere in this report, employing businesses, agricultural businesses, businesses that operate in several locations and businesses requiring a licence, face significant non-tax compliance costs that can exceed the burden of their tax compliance costs.

10.5 These non-tax regulations are often at state and local government levels. Atax noted that it is the breadth and complexity of these regulations that are of major concern to small business, and in addition, in respect of workers compensation, its cost.¹²²

10.6 Workers' compensation and the Superannuation Guarantee appear to be greater concerns for employing businesses than taxation compliance. These concerns were also reflected in the submissions to the Banks taskforce.

10.7 Many businesses in industries such as manufacturing and construction rated occupational health and safety (OH&S) and licensing rules as more significant causes of compliance burden than taxation.

EMPLOYMENT COMPLIANCE COSTS

10.8 There was strong consensus among small businesses and tax agents that employment of staff imposes significant regulatory compliance costs. This belief was also consistent with the Australian academic literature and other Australian sources on compliance costs.

10.9 Employing businesses have regulatory obligations associated with labour issues such as employment declarations, workers' compensation, superannuation and occupational health and safety.

10.10 Employment can be a significant threshold compliance issue for small businesses, and the number of employees a business has can influence its perceptions of compliance burden. For some businesses the employment compliance burden may be a barrier to business growth.

10.11 Atax noted that award or over award wages were usually paid as a means of reducing compliance costs associated with the industrial relations system.¹²³

SUPERANNUATION

10.12 Several aspects of superannuation appear to cause compliance issues for small businesses.

- Businesses that managed their own superannuation funds found the related compliance requirements difficult. Tax agents confirmed that there were significant complexities involved in assisting their small business clients with self

122 Atax p 45.

123 Atax p 46.

managed superannuation funds (SMSFs). Nevertheless, the numbers of SMSFs are growing rapidly.¹²⁴

- Uncertainty of the classification between an employee and a contractor for superannuation 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 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.¹²⁵

OCCUPATIONAL HEALTH & SAFETY AND WORKCOVER

10.13 The Atax study concluded that compliance with occupational health and safety legislation was generally not regarded as a concern by the businesses it surveyed, largely because few ensured that they were fully compliant. Atax commented that those who were more aware of the OH&S requirements reported that 'many of the rules were ridiculous, inflexible and unmanageable for small business'.¹²⁶ The calculation of WorkCover charges also was perceived to be difficult, with variations across state jurisdictions. The perceived excessive cost of WorkCover was also cited as an issue which increased the frustration of employers. Atax concluded that 'small businesses would generally be in breach of OH&S regulations'.¹²⁷

10.14 In addition, the lack of harmonisation of workers' compensation laws across state boundaries appears to add compliance burdens to those businesses with staff in more than one jurisdiction.¹²⁸

124 As at 31 March 2007 there were 337,902 self managed superannuation funds. In the year to March 2007, there were 23,111 SMSF registrations, an increase of 51 per cent on the previous year to March 2006. Source: ATO.

125 Office of Small Business, Regulatory Compliance Case Studies Pilot, Hospitality Sector May 2003.

126 Atax p 27.

127 Atax p 40.

128 Banks' submissions and Atax p 46.

10.15 CPA Australia found in its 2003 survey of small businesses that the larger the business the more difficulties it had complying with OH&S requirements.

WORKPLACE RELATIONS LEGISLATION

10.16 Compliance with aspects of the workplace relations system was raised during this study as a significant compliance issue for some small businesses. While concerns were described in the context of the WorkChoices legislation, several of the issues pre-date WorkChoices.

10.17 The record keeping requirements of the legislation appear to be the main concern for employers. The requirements included the need to supply detailed pay slips to staff and keep workforce records for seven years. Recent changes to the *Workplace Relations Regulations 2006*, which took effect from 27 March 2007, provide a simplified set of record keeping and pay slip requirements which should reduce the administrative burden on employers.

Parental leave

10.18 The longstanding parental leave provisions contained in federal workplace relations legislation entitle employees to a period of up to 12 months unpaid parental leave. Some small businesses consider that this requirement imposes a significant compliance burden on them because they are required to undergo additional administrative burdens in temporarily filling, or otherwise managing, staff absences of up to 12 months. However, this is largely an issue of policy, rather than a compliance cost issue.

INDUSTRY-SPECIFIC COMPLIANCE COSTS

10.19 Atax found that the most onerous non-tax compliance requirements tended to be industry-specific requirements.¹²⁹ This may be because there are limited opportunities to outsource these compliance obligations to third parties. Small businesses engaged in agriculture reported a particularly heavy burden in complying with environmental requirements (especially related to chemicals), development regulations, and occupational health and safety requirements.

10.20 Industries where workplace safety is a concern, such as manufacturing and construction, are likely to have higher regulatory burdens. The construction industry, in particular, has to comply with planning and approvals processes resulting in compliance costs from paperwork and time delays and fees. The mining industry has to deal with a combination of employment issues, immigration laws, native title, and inconsistencies between state and local jurisdictions' requirements.

129 Atax p 46.

APPENDIX 1: PRESS RELEASE 2005/095

BOARD OF TAXATION TO UNDERTAKE SCOPING STUDY OF SMALL BUSINESS TAX COMPLIANCE COSTS

As part of the Government's commitment to reducing the regulatory burden on business, I have asked the Board of Taxation to work closely with small businesses (especially micro business) in order to identify and analyse the main costs they face in complying with taxes administered by the Australian Taxation Office.

The Board will undertake a scoping study of tax compliance costs facing the small business sector and identify the more important areas where compliance costs might be reduced. It will provide a final report in the second half of 2006. Interim reports may be provided.

I have asked the Board to concentrate on the source of concerns of the small business sector. The findings of the study will help with the Government's ongoing efforts to reduce excessive tax compliance costs facing business, particularly the small business sector.

The Board's report will take into account:

- the purpose and object of the law;
- the relationship between taxpayer compliance costs and government administration costs;
- costs incurred by business for non-tax reasons and any additional costs incurred by businesses or their advisors for tax reasons (tax compliance costs);
- transitional costs and ongoing tax compliance costs;
- taxpayer circumstances and commercial practices;
- other legislation; and
- any other matters the Board considers materially impact on small business tax compliance costs.

Scoping study of small business tax compliance costs

The Board of Taxation's charter includes providing advice to the Government on the quality and effectiveness of tax legislation along with the general integrity and functioning of the tax system. Reducing compliance costs and complexity has been a focus of the Board's recent activities.

Details about the Board of Taxation can be found at <http://www.taxboard.gov.au>.

4 November 2005

MELBOURNE Contact: Amanda Kennedy 03 9650 0244

APPENDIX 2: BANKS TASKFORCE TAX REGULATION RECOMMENDATIONS

Banks taskforce — tax regulation measures and Government response

Recommendation (as summarised on page xii of Banks report)	Agreed by Govt?	Summary of Government Response ¹³⁰	Status as at June 2007
5.29 Limit FBT reporting to remuneration benefits		See 5.30	
5.30 Increase the FBT reporting threshold	In part	The Government had previously agreed to increase the reportable fringe benefits exclusion threshold from \$1000 to \$2000 from 1 April 2007. The Govt agreed in principle to a reporting exclusion for pooled or shared vehicles.	An increase in the reporting threshold was included in <i>Tax Laws Amendment (2006 Measures No. 5) Act, 2006</i> which received Royal Assent on 23 October 2006. Regulations relating to pooled and shared vehicles commenced on 1 April 2007.
5.31 Increase the FBT minor benefits threshold	Yes	The minor fringe benefits exemption threshold was increased from \$100 to \$300 from 1 April 2007.	Legislation giving effect to this change was contained in <i>Tax Laws Amendment (2006 Measures No. 5) Act 2006</i> which received Royal Assent on 23 October 2006.
5.32 Clarify the FBT minor benefits threshold exemption guidelines	Yes	ATO was to review its existing guidelines and provide further guidance. Draft ruling TR 2007/D6 was issued on 27 June 2007.	Final ruling Pending.
5.33 Reduce compliance cost for FBT on road tolls	Yes	The Government had previously agreed, and the ATO is reviewing administrative solutions which reduce the compliance costs of calculating FBT on road tolls and better publicise the work it has already done.	
5.34 Review to investigate reducing FBT and GST interaction and FBT treatment of car parking	No	Interaction between FBT and GST is appropriate. Standard valuation method for car parking would increase compliance costs and raise equity issues.	

130 These are the responses of the previous Government.

Banks taskforce — tax regulation measures and Government response (continued)

Recommendation (as summarised on page xii of Banks report)	Agreed by Govt?	Summary of Government Response	Status as at June 2007
5.35 Consider allowing optional group FBT returns	No	Might increase compliance costs. May consider non-legislative means to provide this option in some circumstances through.	
5.36 Allow employers the same extension to lodge FBT returns as tax agents	No	Tax agent extension recognises their role in preparing for many clients, and the ATO has power to grant extensions in appropriate cases.	
5.37 Provide a simplified accounting method for restaurants, cafes and caterers	Yes	The ATO would develop a simplified accounting method for small restaurants, cafes and caterers which are unable to use the current 'snapshot method', taking account of the announcement to align the eligibility threshold for various small business measures.	A New Tax System (Goods and Services Tax) Simplified GST Accounting Methods Determination 2006/1 came into effect on 1 October 2006. A threshold of \$2 million was used.
5.38 Increase the compulsory GST registration threshold	Yes, in principle	The Government would consider the proposal further in the context of the change to the definition of GST announced in the 2006-07 Budget.	The Government announced in the 2007-08 Budget that the threshold for compulsory GST registration would increase from \$50,000 to \$75,000 from 1 July 2007.
5.39 Promote BAS policy for capital items worth \$1000 or less	Yes	Previously agreed. The ATO would promote its policy to allow items with a cost of less than \$1000 to be reported on BASs as non-capital. This applies to acquisitions that would otherwise have to be recorded at item G10 on a BAS, if the business does not record capital acquisitions separately and expects annual turnover to be less than \$1 million. Revised GST Activity Statement instructions, published July 2006, contain advice.	No further action required.
5.40 Examine providing brief explanatory information on the BAS.	No	ATO advised there is little scope to add meaningful information on the one-page BAS form, but it would examine means of improving information to taxpayers.	
5.41 Incorporate the Medicare Levy into personal income tax rates	No		
5.42 Increase the PAYG threshold for quarterly remitters	No	While it may have reduced some compliance costs, it would result in substantial revenue deferral.	

Banks taskforce — tax regulation measures and Government response (continued)

Recommendation (as summarised on page xii of Banks report)	Agreed by Govt?	Summary of Government Response	Status as at June 2007
5.43 Align and rationalise definitions in the tax law including 'small business', 'employee', 'salary and wages', and 'associate'	Yes, in principle	The Government agreed in principle to align definitions in the tax law.	The Small Business Framework, which began on 1 July 2007, uses a \$2 million turnover threshold to access a range of small business tax concessions.
5.44 Align definitions of 'employee' and 'contractor'	No	This would reduce Superannuation Guarantee coverage and possibly compliance.	
5.45 Harmonise payroll tax administration across States and Territories	Yes	The Government would support moves by the States and Territories to harmonise these through COAG.	
5.46 Harmonise stamp duty administration across States and Territories	Yes	Agreement reached between Government and States on a schedule for the abolition of the majority of taxes listed for review in the IGA, over four years from 1 July 2006.	
5.47 Standardise tax administration across jurisdictions	Yes	Commonwealth Government would work within COAG and the Ministerial Council to harmonise administration and tax base of like taxes across jurisdictions.	
5.48 Issues for consideration by Board of Taxation	Yes	The five issues were referred to the Board of Taxation.	The five issues are being considered within the scoping study.

APPENDIX 3: ORGANISATIONS AND INDIVIDUALS LOGGING SUBMISSIONS

No.	Submitting organisation	Date received
1	Institute of Chartered Accountants in Australia (ICAA)	24/02/06
2	Motor Trades Association of Australia (MTAA)	27/02/06
3	Tax Institute of Australia	27/02/06
4	Australian Chamber of Commerce and Industry	08/03/06
5	Penna Michael (Alistair Michael)	18/04/06
6	Restaurant & Catering Australia	18/04/06
7	CPA Australia	28/04/06
8	Mr M P Sumner-Potts	03/05/06
9	Council of Small Business Associations in Australia (COSBOA)	05/06/06
10	Real Estate Institute of Australia	29/06/07

Submissions to the Banks Taskforce (Taskforce on Reducing Regulatory Burdens on Business) considered as part of this study

These submissions raised issues in relation to the small business tax compliance costs of small businesses.

Submitting organisation	Banks submission number
Brett Bondfield	80
Business Council of Australia	109
Corporate Tax Association	68
Council of Small Business Organisations of Australia Ltd	17
CPA Australia	113
Distilled Spirits Industry Council of Australia	24
Institute of Chartered Accountants in Australia	41
Investment and Financial Services Association	89
Robert Jones (VEBIZ)	8

Scoping study of small business tax compliance costs

Submitting organisation	Banks submission number
National Association of Retail Grocers of Australia	40
National Institute of Accountants	107
MYOB Australia	2
Office of Small Business – ACT Government	7
Restaurant & Catering Australia	70
Small Business Development Corporation of WA	87
Starkis Design	5
State Chamber of Commerce (NSW)	35
Taxation Institute of Australia	78
Telstra Corporation	66
Victorian Automobile Chamber of Commerce	33

APPENDIX 4: CONSULTATION MEETINGS

Date	Attendees
3 February 2006	ATO Centre for Philanthropy and Non-Profit Studies and Non-profit Income Tax Advisers
20 February 2006	Not-for-profit representatives
8 March 2006	Perth not-for-profit representatives
9 March 2006	Perth small business operators and small business advisers, and not-for-profits
28 March 2006	Sydney small business operators
20 September 2006	Small business representatives, tax practitioners and a software developer
14 and 16 November 2006	Tax practitioners
13 April 2007	Adelaide small business operators
25 May 2007	ATO Small Business Advisory Group
13 June 2007	ATO Commissioner's Small Business Consultative Group

APPENDIX 5: LITERATURE REVIEW

The following papers and reports on tax compliance costs were considered as part of this study.

Australian research

No.	Date	Title	Author(s)
1	2006	Beyond 4100 — A report on measures to combat rising compliance costs through reducing tax law complexity	C John Taylor — Report prepared for the Taxation Institute of Australia (Hard copy provided by library — electronic text found at the Tax Institute website. http://www.taxinstitute.com.au/)
2	2006	Ch 13 Administration and Compliance costs of taxation	International Comparison of Australia's Taxes — Report prepared for the Treasurer (Hard copy)
3	2006	Rethinking Regulation ('the Banks' report)	Regulation Taskforce (Gary Banks, Rod Halstead, Richard Humphrey, Angela MacRae) — Report to the Prime Minister and Treasurer www.regulationtaskforce.gov.au
4	2006	Reducing the regulatory burden: the way forward	Gary Banks — Chairman, Regulation Taskforce and Productivity Commission Speech presented to the Centre for regulatory studies — Monash University, Melbourne, in relation to the release of the Banks Report http://www.pc.gov.au/speeches/cs20060517/cs20060517.pdf
5	2006	A silver lining in the tax compliance cost cloud? A study of the managerial benefits of tax compliance in small business	Philip Lignier — Central Queensland University Paper presented at the 7 th International Tax Administration Conference, Sydney, 2006 (Hard copy only)
6	2005	Business start-up compliance costs: Policy perspectives	Nthati Rametse and Jeff Pope - Curtin University (Journal of the Australasian Tax Teachers Association) http://www.austlii.edu.au/au/journals/JATTA/2005/31.html
7	2005	The GST recurrent compliance costs/benefits of small business in Australia: A case study approach	John Glover and Binh Tran-nam — Monash University & University of NSW (Journal of the Australasian Tax Teachers Association) http://www.austlii.edu.au/au/journals/JATTA/2005/17.html

Scoping study of small business tax compliance costs

No.	Date	Title	Author(s)
8	2005	Tax system complexity and compliance costs — some theoretical considerations	Tracy Oliver and Scott Bartley, Australian Treasury (Economic Roundup, Winter 2005, Treasury)
9	2005	Benefits & costs of regulation	Access Economics report prepared for the Business Council of Australia
10	2005	Mixed blessing of being designated a small business	J Arendse, S Karlinsky, S Killian, G Payne http://aaahq.org/ata/meetings/midyear-meetings/2006/pdf/mixedblessingATA.pdf
11	2004	Small business: the first casualty of tax reform compliance costs	Michael Dirkis (Tax Institute of Australia) Brett Bondfield (University of Technology, Sydney) http://services.thomson.com.au/cpdnews/docs/DirkisBondfield.pdf
12	2003	Reducing the business costs of regulation	Gary Banks — Productivity Commission (address to small business coalition, Canberra) http://www.pc.gov.au/speeches/cs20030320/cs20030320.pdf
13	2003	Studying the studies: An overview of recent research into taxation operating costs.	Chris Evans — University of NSW (eJournal of Tax Research) http://www.austlii.edu.au/au/journals/eJTR/2003/4.html
14	2001	The operating costs of taxation: a review of the research	Chris Evans — University of NSW (Atax) http://docstore.ingenta.com/cgi-bin/ds_deliver/1/u/d/ISIS/30002502.1/bpl/ecaf/2001/00000021/00000002/art00286/BF775060605E08041150687852F8182311B6AAB8AF.pdf?link=http://www.ingentaconnect.com/error/delivery&format=pdf
15	2000	Tax compliance costs: research methodology and empirical evidence from Australia	Binh Tran-Nam, Chris Evans, Michael Walpole — UNSW (Atax) Katherine Ritchie — Manukau Institute of Technology, Auckland National Tax Journal Vol. 53, no. 2 pages 229-252
16	1999	Why small business are not hiring — Regulatory impediments to small business growth	Jason Soon and Helen Hughes (Australian Treasury) http://www.cis.org.au/IssueAnalysis/la6/la6.html
17	1997	Reducing the regulatory burden: does firm size matter?	I Bickerdyke, R Lattimore — Staff Research Paper — Industry Commission http://www.pc.gov.au/ic/research/information/regburd/regburd.pdf
18	1997	A report into Taxpayer Costs of Compliance	C Evans, K Ritchie, B Tran-Nam, and M Walpole, AGPS, Canberra
19	1996	Compliance costs of taxation in Australia	Dr Stephen Rimmer, Office of regulation review, Industry Commission (forming the Productivity Commission), Canberra http://www.pc.gov.au/orr/reports/submission/compltax/compltax.pdf
20	1998	Regulatory Best Practice and Taxpayer Compliance Costs	Dr Stephen Rimmer, Office of Regulation Review (forming part of the Productivity Commission), Canberra

Overseas research

No.	Date	Title	Author(s)
1	2006	Tax compliance costs of New Zealand Small Businesses, 2004: Designing the survey for its policy purpose	Prue Oxley and Darshana Elwela Paper presented at the 7 th International Tax Administration Conference, Sydney, 2006
2	2005	Measuring the tax compliance costs of small and medium-sized businesses — a benchmark survey	NZ Inland Revenue, research undertaken by Colmar Brunton.
3	2005	The Impact of Regulatory Costs on Small Firms	W M Craine, SBA Office of Advocacy — United States http://www.sbaonline.sba.gov/advo/research/rs264tot.pdf
4	2004	The tax compliance costs of small and medium-sized businesses	Chris Evans, Binh Tran-Nam, ATAX Report commissioned by NZ Inland Revenue for the scoping phase of a project on tax compliance costs borne by NZ SMEs.
5	2004	Quantifying compliance costs of small businesses in NZ	W R J Alexander, J D Bell, S Knowles — University of Otago http://divcom.otago.ac.nz/ECON/research/discussionpapers/DP0406.pdf
6	2003	Making tax easier for small business (Chapter 2 — Small business and tax)	A government discussion document — New Zealand http://www.taxpolicy.ird.govt.nz/publications/files/html/makingtaxeasier/c2.html
7	2003	Tax regulation and small business in the USA, UK, Australia and NZ	F Chittenden, S Kauser, P Poutziouris — University of Manchester, UK (Hard copy provided by Treasury Library)
8	2002	Regulatory Burdens of Small Business: A Literature Review	F Chittenden, S Kauser, P Poutziouris — University of Manchester, UK http://www.sbs.gov.uk/SBS_Gov_files/researchandstats/Regulation-Report.pdf?nourl=www.dti.gov.uk/publications/pdflink/&pubpdfdownload=02%2F1378
9	1997	The income tax compliance burden on small and medium-sized Canadian businesses	B Erard, Carleton University – working paper 97-12 prepared for the Technical Committee on Business Taxation http://www.fin.gc.ca/taxstudy/wp97-12e.pdf
10	2004	Tax compliance costs of small businesses 2004: improving the estimates	Prue Oxley and Stuart Turner (Inland Revenue, NZ) Charles Sullivan, Capital Research, Wellington, NZ
11	2005	Tax policy — Summary of estimates of the costs of the federal tax system	United States Government Accountability Office — Report to congressional requesters

A summary of the findings of this literature is below.

Literature review summary

This summary provides the main themes found in the literature, from both Australian and overseas studies. The period reviewed spans from 1997 to 2006 with the majority of literature reviewed written in the period 2004-2006. There is no discernable difference between findings of studies relating to small business compliance costs undertaken in different tax jurisdictions, so no distinction will be made between studies conducted in the different countries.

This summary will focus on the findings in relation to tax compliance rather than other types of regulation. The academic literature generally defines a small business as one that employs 20 people or less.

Common themes

Definition of compliance costs

There was general consensus that tax compliance costs are those costs incurred by the business in complying with tax regulation, over and above the payment of the taxes themselves.

There were some differences between terms used to describe compliance costs, however there were common elements to the various terms. Generally, total compliance costs include the value of time lost by business in complying with regulation including time taken to train staff in regulatory requirements, the cost of external advisors, non-labour costs such as the use of computers for record keeping, costs of specific publications, and specific travel related to complying with regulations.

Net compliance costs reduce total compliance costs by net benefits, including managerial benefits (that is, better record keeping systems for decision making), cash flow benefits, tax deductibility and cash grants from governments. In most studies, psychological costs including stress, anxiety and frustration experienced by business in dealing with regulatory requirements were acknowledged as a cost of compliance, but were considered too difficult to measure and so were not included in calculations of compliance costs in any of the research.

There was agreement that compliance costs included the diversion of management resources from core business. This is considered a non-monetary cost of compliance.

In most studies there was a distinction between voluntary (tax advice to minimise tax liability) and mandatory (costs in complying with statutory obligations) costs, start-up costs, temporary and regular costs, monetary (collecting and paying taxes) and non-monetary (acquiring knowledge of regulatory requirements) costs.

Small businesses (that is, those with fewer than 20 employees) have a higher compliance burden than larger businesses.

This is thought to be because of the fixed nature of compliance costs and economies of scale available in larger businesses. In addition there is a contention that tax compliance expertise is not generally available in house for smaller businesses, adding to costs of engaging external advisors.

There is a consensus that tax compliance costs are amongst the highest regulatory burdens faced by small business. Compliance costs make up about 20 per cent of a business's administration costs. Around two-thirds of the time spent on compliance activities are related to tax compliance activities. In 1997 compliance costs in Australia were estimated to be 1.36 per cent of GDP.

Compliance costs are regressive

The larger a business is, the smaller its compliance costs are as a percentage of turnover. In some cases, this extends to negative compliance costs for large businesses. This is a result of larger businesses generally having tax compliance expertise in house (reducing the need to pay for external advice), economies of scale, and larger businesses being in a better position to take advantage of cash flow benefits and tax deductibility of compliance costs.

There is a difference in compliance costs at different stages of the business life cycle

There is agreement amongst researchers that compliance costs are larger in the start-up phase of a business. Start-up costs can also refer to costs incurred as a result of new or changed legislation. There is a contention that half of start-up costs relate to costs of external advisors. Start-up costs as a percentage of income are higher in smaller businesses largely due to lack of economies of scale and lack of own expertise in regulatory requirements. Costs then reduce as expertise increases within the business, and those costs become recurring costs.

General agreement that governments in all jurisdictions recognise the compliance burden on small business

Governments recognise that small businesses bear a disproportionate burden of compliance costs. Governments have implemented some processes to reduce the compliance burden, but researchers tend to agree that there is little evidence of progress.

An interesting point noted in several studies is the suggestion that compliance costs can be shifted to the government, thereby increasing administrative costs. Alternatively a reduction in taxpayer compliance costs may lead to an increase in administrative costs as the government devotes more resources to checking compliance.

Australian research post- 2000 indicates a significant increase in TNTS-related compliance costs faced by small businesses, compared with a minor increase in governments' administration costs.

Reasons for high compliance costs

Several reasons were put forward in Australian studies:

- sheer volume of legislation, complexity and rapid legislative change;
- complexity in the market place (for example increasing globalisation, complex business structures);
- incentives offered to small businesses (for example STS, CGT concessions) attempt to reduce compliance costs, but usually increase complexity;
- while underlying policy objectives are sound, poor regulatory design and lack of robust consultation processes have resulted in unnecessarily complex law; and
- regulatory overlaps and inconsistencies between different levels of government.

APPENDIX 6: SMALL BUSINESS TAXATION INITIATIVES ANNOUNCED IN THE 2006-07 AND 2007-08 BUDGETS

Date of announcement	Area of Tax	Details	Commencement Date
9 May 2006 Budget (PR Tsr 2006/039)	STS	Several changes to the Simplified Taxation System (STS) such as increasing the STS average annual turnover threshold from \$1 million to \$2 million, removing the \$3 million depreciating assets test, extending depreciating asset roll over relief to STS taxpayers, extending depreciating asset roll over relief to STS taxpayers, and allowing STS taxpayers to pay quarterly PAYG instalments on the basis of GDP-adjusted notional tax. However, the STS has since been abolished and replaced by the small business framework, which will provide similar concessions to all small business entities with turnover under \$2 million.	Most of these initiatives were expected to come into effect on 1 July 2007, but the STS was instead replaced by the Small Business Framework from 1 July 2007. Small business entities can access the PAYG(I) concessions from 1 July 2009
	CGT	Change the 15-year exemption, the retirement exemption, the small business roll-over, and how the concessions apply to partnerships. Replace the 50 per cent controlling interest test with a 20 per cent significant individual test.	1 July 2006
	CGT	Increase the net assets threshold from \$5 million to \$6 million for the CGT small business concessions and allow small business entities taxpayers to be eligible for the concessions without having to satisfy the net assets threshold.	1 July 2007
	GST	Small business GST concessions — increase cash accounting turnover threshold from \$1 million to \$2 million and align certain GST definitions of turnover with the STS definition.	1 July 2007
9 May 2006 Budget (PR Tsr 2006/39)	FBT	Increase in-house fringe benefits from \$500 to \$1,000. This will reduce compliance and record keeping costs for employers who provide goods or services to their employees that are identical or similar to goods or services supplied to the public in the ordinary course of the employer's business.	1 July 2007
9 May 2006 Budget (PR Tsr 2006/39)	FBT	Extend FBT remote area concession to cover travel by water.	1 April 2007
9 May 2006 Budget (PR Tsr 2006/39)	FBT	Increase FBT minor benefits from \$100 to \$300 and increase the reporting exclusion threshold from \$1,000 to \$2,000.	1 April 2007

Date of announcement	Area of Tax	Details	Commencement Date
9 May 2006 (PR Tsr 2006/35)	Wine equalisation tax	Changes to the wine equalisation tax (WET) producer rebate effectively exempts a large number of small to medium wine producers (or groups of associated producers) from WET on their domestic wine sales.	1 July 2006
9 May 2006 (PR Tsr 2006/39)	Trusts	Changes to tax arrangements for trusts will clarify obligations and reduce reporting requirements, including allowing family trust elections to be revoked or varied.	Income year following Royal Assent
15 August 2006 (PR Tsr 2006/90)	GST	Some industries (hospitality) can average their inputs. From 1 October 2006, a new legislative determination – <i>A New Tax System (Goods and Services Tax) Act 1999 Simplified Accounting Method Determination (No. 1) 2006</i> — will allow restaurants, cafés and catering businesses to use a new Simplified Accounting Method (SAM) called the purchases snapshot method. To be eligible to use this method, cafés or caterers must have an annual turnover of \$2 million or less (excluding GST).	1 October 2006
15 August 2006 PR 2006/89), 19 December (PR 2006/138) and 30 August 2007 (PR 2007/084)		Standard business reporting programme, aimed at reducing compliance costs for businesses by establishing an IT based system to allow consistent business reporting to Commonwealth, state and local authorities, thereby reducing duplication.	Full implementation mid-2010
13 November 2006 (PR 2006/123) Exposure Draft 9 February 2007 (PR Tsr 2007/03)	Small business framework	Provide a standard threshold of \$2m for access to, income tax, GST, CGT, FBT and CGT and pay as you go small business concessions for small business entities.	1 July 2007
6 December 2006 (MRAT PR 2006/89)	Division 7A-non-commercial loans	The amendments remove the automatic debiting of a company's franking account when a deemed dividend arises; provide a discretion to the Commissioner to disregard a deemed dividend in certain circumstances; and make technical amendments to provide greater flexibility for taxpayers, including changes to FBT law to simplify interaction with Division 7A. The changes were included in Tax Laws Amendment (2007 Measures No. 3) Act, No. 79 of 2007, which received Royal Assent in June 2007.	1 July 2006, but the discretion applies from the 2001-02 income year and the FBT changes from 1 April 2007

Date of announcement	Area of Tax	Details	Commencement Date
1 May 2007 Minister for Industry/Prime Minister press release 'Global Integration — the future for Australian Industry'	ABN and business names registration	The Government will provide \$49 million over four years for the design and construction of a single, streamlined online system to facilitate Australian Business Number and business name registration. Funding will be provided to the Australian Taxation Office, IP Australia, and the Australian Securities and Investments Commission and the Department of Industry, Tourism and Resources to develop the online system, which will be implemented in collaboration with the State and Territory governments through COAG.	2007-08
8 May 2007	GST	Businesses with annual turnover of less than \$75,000 will no longer be required to register for GST (up from \$50,000).	1 July 2007
8 May 2007	PAYG	Small businesses can choose to pay their PAYG instalments on an annual basis, aligning the instalments with the annual GST arrangements and resulting in the need to lodge only one Activity Statement per year.	1 July 2008
8 May 2007	GST	Purchases by businesses valued at \$75 or less will no longer require an approved tax invoice to claim an input tax credit (up from \$50).	1 July 2007
8 May 2007	Excise	Small businesses with excise obligations will be able to settle these on a monthly, not weekly basis.	1 January 2008 or royal assent

APPENDIX 7: RECENT ATO INITIATIVES TO REDUCE COMPLIANCE COSTS

Initiative	Description	Commencement
ATO business portal	Allows a business to conduct tax compliance activities on-line via a digital certificate, for example. lodge or revise an activity statement, view previous activity statements, view business registration details, update certain registration details, request a refund for an account in credit.	Launched March 2004 and refined continually
ATO tax agent portal	A secure website only available to registered tax agents via a digital certificate. Provides tax agents with access to live client account information, live client registration information, client directory, current year income tax lodgment details for clients, online activity statements and online request forms for replacement cheques, running balance accounts, electronic lodgment service password reset, relationship manager programme, refunds and transfers and portal feedback. The portal also provides access to a range of online reports.	Launched October 2002 and refined continually
ATO Website	The standard and content of the ATO website is being continually improved through the implementation of a new publishing system. Tax reform and ATO assist websites combined into one.	2002-03
Phone services	Premium phone services for tax agents. ATO phone services for clients have been improved to provide more personalised and accurate information. A new system, Client Relationship Management (CRM) is now used which facilitates keeping a record of taxpayers' interactions with the ATO to gain a better understanding of its clients and respond more quickly to their requests.	October 2002 2003/04
e-Record	Free and easy-to-use electronic record keeping product developed and distributed by the ATO. It helps small businesses meet their record keeping and reporting obligations. Designed for businesses that use a cash basis of accounting, currently use paper-based record keeping and use one bank account. Distributed free by the ATO and can also be downloaded. E-record is updated annually at the end of each financial year. It is promoted in ATO publications and Activity Statement Updates.	2002

Initiative	Description	Commencement
Assistance to new business	The ATO has dedicated resources and an integrated strategy specifically designed to assist new business. This includes the Early Contact Assistance and Intervention Program and monitoring new business compliance behaviour.	
Tax seminars for small business	The ATO runs a range of free tax seminars designed for small business people. They are mainly designed to assist new business but existing small business operators have benefited from them. Topics include: tax basics, record keeping, employing people and end of year obligations. Other more specialised topics include: alienation of personal services income, fuel tax credits, superannuation, Division 7A, fringe benefits tax, and Uniform Capital Allowances.	
Forums	The ATO has established more than 70 consultation groups to ensure engagement of key stakeholders in the implementation of tax legislation. Those groups include industry partnerships (22 different groups), the National Tax Liaison Group, ATO Tax Practitioner Forum, Corporate Consultative Committee, Small Business Advisory Group, Commissioners' Small Business Consultative Group, Superannuation Consultative Committee, Indigenous Tax Advisory Group, and the Software Developer Consultative Group.	March 2002
Annual GST reporting option	Reduced reporting requirements for BAS. Eligible businesses can choose to calculate and report GST annually rather than quarterly	October 2004

APPENDIX 8: SUPPORTING MATERIAL

Table A8.1: Definitions of small business in Commonwealth legislation (as at July 2007)

Legislation	Context	Abbreviated Definition	Section of the Act
<i>Income Tax Assessment Act 1997</i>	Small business entity (under the small business framework)	<ul style="list-style-type: none"> Small business entity will have \$2 million aggregated turnover. 	s328-110
	CGT	<ul style="list-style-type: none"> Satisfy the maximum net asset value test, that is, have net assets valued at less than \$6 million.¹³¹ 	s152-10 s152-15
<i>A New Tax System (Goods and Services Tax) Act 1999</i>	GST	<ul style="list-style-type: none"> Turnover is used in GST legislation for various purposes, for example, <\$75,000 for non-compulsory GST registration. 	S23-15
<i>Fringe Benefits Tax Assessment Act 1986</i>	Small business car parking	<ul style="list-style-type: none"> Not a government body; and The sum of the employer's ordinary income and statutory income for the year is less than \$10 million.¹³² 	s58GA
<i>Trade Practices Act 1974</i>	Small business collective bargaining	<ul style="list-style-type: none"> Contracts not exceeding \$3 million over 12 months. 	s93AB
	Unconscionable conduct	<ul style="list-style-type: none"> Transactions not exceeding \$3 million and not listed public company. 	s51AC
<i>Privacy Act 1988</i>	Definition	<ul style="list-style-type: none"> A business where annual turnover is \$3 million or less 	s6D
<i>Small Business Development Corporation Act 1983</i>	Interpretation	<ul style="list-style-type: none"> Wholly owned and operated by an individual person or by individual persons in partnership or by a proprietary company, and which: <ul style="list-style-type: none"> has a relatively small share of the market in which it competes; is managed personally by the owner or owners or directors; and is not a subsidiary of, or does not form part of, a larger business or enterprise. 	S3

131 Increased from \$5 million to \$6 million by *Tax Laws Amendment (Small Business) Act 2007*. Small business entities can access this concession from 1 July 2007.

132 Small business entities can access this concession from 1 July 2007.

Legislation	Context	Abbreviated Definition	Section of the Act
<i>Australian Securities and Investments Commission Act 2001</i>	Definition	<ul style="list-style-type: none"> Means a business employing less than: <ol style="list-style-type: none"> if the business is or includes the manufacture of goods — 100 people; or otherwise — 20 people. 	s12BC
<i>Corporations Act 2001</i>	Definition for financial services and markets	<ul style="list-style-type: none"> Means a business employing less than: <ol style="list-style-type: none"> if the business is or includes the manufacture of goods — 100 people; or otherwise — 20 people. 	s761G

Table A8.2: Concessions that can be accessed through the small business entity test

Concession	Are there alternative size-based thresholds that the entity can use to access the concession (subject to other eligibility criteria)?
CGT 15-year asset exemption	Yes. The \$6 million maximum net asset value test.
CGT 50 per cent active asset reduction	Yes. The \$6 million maximum net asset value test.
CGT retirement exemption	Yes. The \$6 million maximum net asset value test.
CGT roll-over	Yes. The \$6 million maximum net asset value test.
Simpler depreciation rules	No.
Simplified trading stock rules	No.
Deducting certain prepaid business expenses immediately	No.
Accounting for GST on a cash basis	Yes. If the entity carries on an enterprise, but does not carry on a business, an alternative test \$2 million turnover test is used to determine eligibility.
Annual apportionment of input tax credits for acquisitions and importations that are partly creditable	Yes — as above.
Paying GST by quarterly instalments	Yes — as above.
FBT car parking exemption	Yes. The \$10 million ordinary and statutory income test.
From 1 July 2009 — PAYG instalments based on GDP-adjusted notional tax	Yes. The \$2 million base assessment instalment income test.

Table A8.3: Other small business concessions

Concession	Turnover \$	Other criteria \$
Entrepreneurs' tax offset	75,000	-
R&D tax offset	5,000,000	1,000,000 (R&D spending)
Debt/equity rules — at-call loans	20,000,000	
PAYG remittance — medium withholder	-	1,000,000 (amounts withheld)
PAYG remittance — small withholder	-	25,000 (amounts withheld)
PAYG instalments — annual	-	8,000 (notional tax)
GST — non-compulsory registration	75,000	-
GST — annual tax periods	75,000	-
GST — quarterly tax periods	20,000,000	-
GST — non-electronic lodgment	20,000,000	-
GST — ITCs — financial acquisitions	-	50,000 (input tax credits)
GST — simplified accounting methods	2,000,000	
GST — business norms method	1,000,000	
FBT — record keeping	-	5,000 + index (aggregate FB amount)
FBT — annual payment	-	3,000 (FBT previous year)

APPENDIX 9: ABBREVIATIONS/GLOSSARY

Abbreviation	Title
ABS	Australian Bureau of Statistics
ACCI	Australian Chamber of Commerce and Industry
ASIC	Australian Securities and Investments Commission
Atax	Australian School of Taxation, Faculty of Law, University of New South Wales
ATO	Australian Taxation Office
Banks report	Report of the Taskforce on Reducing Regulatory Burdens on Business 2006, chaired by Gary Banks
BAS(s)	Business Activity Statement(s)
BCC	Business Cost Calculator. Developed by the Office of Small Business. Used to estimate the cost to business of complying with new or proposed regulation.
Bell Report	<i>Time For Business</i> , 1996, Report of the Business Deregulation Task Force
Board	Board of Taxation
CGT	Capital gains tax
COAG	Council of Australian Governments
CPA	CPA Australia, association of accounting professionals
FBT	Fringe benefits tax
GST	Goods and services tax
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
OBPR	The Office of Best Practice Regulation (part of the Productivity Commission), responsible for the Business cost calculator
OSB	Office of Small Business, Department of Industry, Tourism and Resources
PC	Productivity Commission
RPA	Recognised professional association, as per section 251LA of the ITAA 1936
SMSF	Self-managed superannuation fund
Tax CCC	Tax Compliance Cost Calculator. Similar to BCC but designed specifically for tax measures.

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