



Australian Government

**Australian  
Small Business  
Commissioner**

3 June 2015

Mr Roger Brake  
General Manager  
Tax White Paper Task Force  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Mr Brake

### **Re:think Tax Discussion Paper**

I am writing to provide my observations on the Re:think Tax Discussion Paper.

My views are based on my experiences with small business stakeholders and I largely adopt a small business lens in this submission.

My submission also reflects the experience of my Deputy Commissioner, Dr Craig Latham, who has worked in the New Zealand tax system as Group Manager of the Policy Advice Division (now Policy and Strategy) of Inland Revenue, particularly in relation to the coverage of New Zealand's Generic Tax Policy Process and its Rewrite Advisory Panel.

I would like to start by commending the Treasury on conducting an inclusive, open and constructive conversation on how we can create a better tax system that delivers taxes that are lower, simpler, fairer. I believe that this conversation holds much promise for Australian small business and the wider business environment.

### **The nature of small business**

Small businesses operate through a range of forms, such as company, trusts, partnerships and sole traders. The choice of structure is generally determined by a broad range of issues that include ownership, employment, family and succession planning, asset protection, flexibility around income retention and distribution and capital raising issues, as well as tax considerations. For family enterprises, there may also be special needs concerning family governance, involvement, ownership and succession. However, in some instances, I also note that the choice of entity for small and family business can unfortunately be driven by past practice and the preferences of advisors.

Due to the breadth of the issues that are taken into account in choice of small business structure, there is unlikely to be a “silver bullet” entity that is capable of meeting the diverse needs of all small business and family enterprise without further supporting measures. For example, the introduction of a structure like a US-styled S-Corporation alone is unlikely to meet these varied needs – even if it is extremely carefully designed. Benefits could still be obtained from the introduction of such an entity, but the dividend imputation system means that double taxation of corporate profits is already addressed in the Australian context and there are other significant opportunities that can be realised by adopting broad-based systemic approaches that improve small business taxation across all entities.

In thinking about the impact of tax on small business and the potential for reform, it is also important to understand that the “small business” label is regularly applied to a vast range of businesses. Of course, small business is commonly differentiated by industry, product, region, employing/non-employing and so forth. However, being a small business, for some, may merely be a phase in the business cycle (ie. on the way to becoming a medium to large business). For others, there may be emphasis on entrepreneurship and innovation and the small business entity may be simply a vessel in which to develop and sell intellectual property.

In these situations, there are a range of discrete tax issues that would need to be considered and their importance will vary depending on the precise circumstances of a business. For example, there would be significantly different tax considerations between:

- a small business owner who is seeking to operate a business as an alternative to employment and to ultimately provide for retirement (such as may be the case for some independent contractors); and
- a small business owner who is developing an innovative product design with a view to sale to a technology development company with the resultant funds being used to develop further innovative products.

Also, in some industries, “small businesses” can effectively be “large” in terms of the other businesses operating in that industry. For example, in industries like agriculture, forestry and fishing, and rental, hiring and real estate services the small business share of output is around the 80% mark. These industries can be viewed as small business industries.

The result of this diversity amongst small businesses is that it is difficult for a tax regime to provide for the needs of all small business except through:

1. the construction of the high level structure of the system (such as by having low rates, a broad base, design that clearly targets the compliance burden and a system that is receptive and flexible to the needs of users); and/or
2. targeted small business measures.

In the remaining parts of this submission, I will focus on these key ways that a tax system may be designed in a way that benefits small business.

## **Small business and the general compliance burden**

Tax should not be viewed as a separate regulatory environment for small business in isolation from other regulatory compliance. The regulatory environment for small business is a mix of overlapping burdens – commercial and corporate law, occupational health and safety, employment obligations, tax and so forth. In confronting the compliance burden in this environment, small business does not necessarily view tax compliance as separate to the other regimes that must also be complied with by the business.

It is also important to recognise that the overlapping compliance burdens impact small business disproportionately when compared to larger businesses that are subject to the same obligations. For example, small businesses commonly single out the Business Activity Statement as a source of frustration, despite frequency being varied for small business. The GST labels on the Statement are a particular source of this frustration and these are principally due to the underlying complexity of the legislation. Similarly, even when designing concessions for small business, complexity around matters like qualification for the small business CGT concessions poses real difficulties for small business.

As noted, the general compliance burden of the tax system for small business operators has a disproportionate impact on small business (compared to larger business). This is in part due to the burden commonly falling on the small business operators themselves (and not specialised employees who deal with compliance matters or even their trusted advisors). As a result, a key approach to meet the needs of small business is to meet the needs of all business through the simplification of tax laws and reducing compliance burdens across the entire system.

## **Specific small business tax rules**

Alongside a blanket approach of reducing the compliance burden across the entire tax system, I strongly argue for the retention (and expansion) of small business tax concessions since these concessions are of significant benefit to small business and help adapt the tax system to better provide for the needs of small business, such as:

- Simplified rules that are targeted at small business to reduce the regulatory burden (such as, those relating to GST registration and payment, tax accounting, simplified depreciation and the Superannuation Clearing House);
- Research and development tax incentives, employee share schemes and the like that are targeted at entrepreneurs/innovators;
- Capital gains tax exemptions for small business (such as the 15 year exemption, small business retirement exemption, 50% active asset reduction and small business rollover) that are critical for small business planning; and
- The reforms in the recent Jobs and Small Business budget package that included tax rate reductions, immediate asset depreciation and deduction of professional costs for starting a business, CGT rollover on change of business structure, and crowd-sourced equity funding.

I also support specific small business tax rules that apply for certain industries such as the agricultural sector. For example, such rules can assist with the particular conditions in the agricultural industry where incomes can vary significantly from year to year depending on factors such as international prices and environmental effects (such as flood and drought). These rules seek to overcome issues that would otherwise penalise businesses that operate in a progressive tax system that is based around a fixed tax year.

I would also encourage innovative thinking around whether a separate opt-in highly simplified tax system could be introduced to cater for the needs of micro/small business. This could include a “deregulated zone” where the record keeping for such businesses is highly simplified and matches that needed for other regulatory compliance and good business practices. There would appear to be little risk to revenue at this end of the business spectrum and significant advantages could be realised for entrepreneurial start-ups and other businesses that occupy this part of the spectrum.

Such a simplified tax system could involve reconsideration of long-standing approaches, such as the application of the capital revenue distinction where there can be an uneasy operation of the distinction when commencing and operating a small business. In terms of operating a small business, immediate deduction/depreciation of items (such as in the recent Jobs and Small Business package) makes sense in terms of the operation of a business that is focused on turnover and cash flow, and where there may not be any real benefit from particular expenditure beyond the year in which the expenditure is made (as the business develops, grows and changes).

### **The small business voice in developing tax policy**

The Discussion Paper raises the question of whether the arrangements for developing tax policy in Australia could be improved. I believe that there is always improvement that government can accomplish in how it interacts with, listens to and converses with small business. The Paper raises the issue of whether there might be learning that can be had from the United Kingdom or New Zealand approaches. I would agree that there are likely to be significant learnings, but the context of those systems needs to also be taken into account.

For example, in thinking about the New Zealand approach, it is important to recognise that it is based on repeated interactions within a tax policy community where participants know each other and have regular contact. The special relationship between participants was referred to in a recent paper by Little, Nightingale and Fenwick where the authors argue that the environment itself produces “strong incentives to cooperate and build trust” (see S. Little, G.D. Nightingale and A. Fenwick, *Development of Tax Policy in New Zealand: The Generic Tax Policy Process* (2013) 61:4 Canadian Tax Journal 1043, also <<http://www.ctf.ca>>).

The New Zealand environment was in part built through the introduction of its Generic Tax Policy Process (“GTPP”) where there is agreement between the participants in the system to use that process in developing and implementing tax policy (and there are significant concerns raised by the profession where there are departures from the approach). The result is that the private sector becomes a strong advocate for the tax system (and its reform) and is willing to raise and support reforms that are not in its own best interests but are in the best interests of the country. Within that system there is also strong engagement between the tax policy arm and the tax administration/regulatory arm (including through the location of Policy and Strategy within Inland Revenue).

A real key to the New Zealand approach is that consultation and collaboration occurs throughout the policy process – from strategy, through the development of the work programme, the policy process and through to implementation and post-implementation review. Although the special circumstances that have allowed the GTPP to flourish in New Zealand may take time to develop in Australia, I think that much can be learnt from the way that the process itself is conducted – there is an openness to engage, listen and co-design tax policy. Furthermore, I believe that government has a responsibility to foster an environment in Australia where there are “strong incentives to cooperate and build trust”.

The close relationship that has developed between the policy and administrative arms in the New Zealand system is another important factor that may be of relevance. This relationship provides a platform to ensure that practical impacts on small business can be taken into account and a facilitative approach to regulation more likely to be adopted.

### **Tax Principles that benefit business**

The Discussion Paper is focused on opportunities to deliver taxes that are “lower, simpler, fairer”. To accomplish this objective, the paper references the general principles for tax systems of equity, efficiency and simplicity. In addition to these well-known principles, I would like to draw attention to two other important principles that provide the environment for a good tax system to flourish over time, namely:

1. A system that follows clear principles that are well understood and coherent; and
2. A system that is well-maintained over time.

By following clear principles that are well-understood and coherent, small business is able to comply with tax law in a way that makes intuitive sense. In approaching such a system, a “sense” of the coherent system means that businesses are able to naturally comply even without understanding deep legal nuances. This encourages business to be and remain compliant and has the added effect of reducing the compliance burden.

Perhaps even more importantly, a system that is well-maintained to reflect changes that are happening in the broader environment is one that has the ability to work with business rather than against it. Enforcement of rules that have dropped out of step with current business practices are of particular concern to small (and other) business. Similarly, systemic approaches to the resolution of disputes through low cost, speedy dispute resolution can assist on a case-by-case basis where a system’s maintenance lags and particular issues may emerge.

Returning to the New Zealand approach under its GTPP, there might also be lessons that can be learnt from the emphasis given to the maintenance of the system. This includes through the use of New Zealand’s standing Rewrite Advisory Panel (the “Panel”) to progress consultation on remedial matters that might be difficult or inefficient to consult on. The sorts of issues that can be considered by the Panel are those that might be limited to narrow areas that would normally only be open to reform when considered alongside other issues in systemic reviews of the system. These are the “rats and mice” of a tax system that, although maybe not affecting a broad range of taxpayers, can impact small groups of taxpayers in significant ways depending on their circumstances.

The Panel, which includes government and private sector members (and is chaired by an appointee from the private sector), was established in 1995 to consider and advise on issues arising during the rewriting of New Zealand's *Income Tax Act 1994*. However, in March 2010, the New Zealand Minister of Revenue announced that the role of the Panel would be expanded to include remedial matters beyond the rewrite project (see <http://www.rewriteadvisory.govt.nz>). This approach means that consultation may be appropriately accomplished in any part of the tax system and on relatively minor/isolated (although important) issues without the need to wait for a review or other significant activity in an area.

### **Communicating with small business**

In order to successfully design and implement tax changes, it is critical to communicate effectively with small business. In particular, I believe that government has a responsibility to assist small business to understand the importance and operation of any legislative or other regulatory changes.

Approaches may include making targeted information available through government sources. This would include working through existing links such as the Australian Small Business Commissioner (shortly, the Australian Small Business and Family Enterprise Ombudsman) and the *business.gov.au* website. However, it also includes communicating with small businesses through their trusted advisors (particularly accountants, lawyers and business advisors) and professional associations. Alongside government channels, these private sector channels should form a key plank in advising and assisting small businesses with change.

In talking with small business, some of the approaches that have the greatest impact include the use of case studies to demonstrate changes in practical ways, the provision of industry-specific information, and templates and tools that assist with change. However, I note that special effort is generally needed to reach unaffiliated businesses (many sole traders will fall into this category).

Unaffiliated businesses may not participate in industry networks and may also be less likely to access government sources of information. The key to reaching this audience is through trusted advisors, principally accountants, whilst regional and other face-to-face meetings may have a significant impact especially through the informal networks of small business (such as other businesses, customers and the like).

If you would like to discuss this letter in further detail please do not hesitate to contact either myself or Dr Craig Latham on (02) 6263 1506 or at [craig.latham@asbc.gov.au](mailto:craig.latham@asbc.gov.au).

Yours sincerely



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