HLB Mann Judd

27 April 2009

Dr Ken Henry
c/- Review Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

By email: AFTSubmissions@treasury.gov.au

Dear Sir

Submission – Australia's Future Tax System Consultation Paper
Tax treatment of Small to Medium Sized Enterprises

We are pleased to provide our comments on Australia's Future Tax system Consultation Paper (Consultation Paper) released for public comment in December 2008.

We support the Ken Henry review process and raise the following issues for your consideration specifically in relation to the small to medium sized enterprises (SME) sector. Our comments address Consultation Questions 4.5, 4.13, 6.5 - 6.6, and 8.3.

1. Definition of SME

The Australian taxation landscape has never really come to terms with the concept of what it means to be a small business vis-à-vis small to medium sized businesses and larger businesses. Whilst various attempts have been made by successive governments to demonstrate that they have an understanding of what a small business is, tax initiatives in the SME sector have been ad-hoc and reactive in nature.

This has contributed to policy makers failing to properly identify and target relevant tax concessions in this sector. The (former) Howard government's legislation to standardise the eligibility criteria for small business tax concessions was a (small) step in the right direction. However, what is clear is that a change in approach is well overdue.

It is recommended that in the medium to longer term, one would like to see agreed upon definitions not only around the term SME, but also its various sub-sets (eg micro-business, entrepreneur etc) and tax policy set accordingly.

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2. Criteria for SME tax reform

It is generally accepted in tax literature that the essential criteria for assessing a tax system are equity, efficiency and simplicity, although there are also a number of other additional factors that may be considered when evaluating a tax system. These design criteria were noted by the Australian Treasury in discussing the (former) Hawke/Keating government's tax reform proposals (which were later introduced in the 1985 year).

Inevitably, however, the objectives of equity, efficiency and simplicity are quite often in conflict and a compromise must be "struck". This usually means that various degrees of acceptability, when evaluating each objective, will only ever be achieved. Ultimately, complexity in the law creates inequity. By way of example, the complexity involved in accessing any of the small business CGT concessions is irrefutable. In this regard, it is encouraging that this issue has already been acknowledged as a major area of increasing complexity in the Consultation Paper.

The weight of tax literature and surveys (amongst others) supports the view that SME tax concessions should first, and foremost, follow the principle of 'simplicity'. Accordingly, in trying to strike a compromise between the objectives of equity, efficiency, and simplicity, and given the nature and type of taxpayers operating in the SME sector, **it is recommended that such objectives should be ranked in order of importance as follows: simplicity, equity and efficiency.** This can only be achieved if tax legislation can be easily understood by SMEs, the benefits clearly demonstrable and calculable, and with minimum external specialist advice required by them for its implementation.

3. Australian SME tax policy

The importance of the SME sector to the Australian economy means that economic policy must take into account the impact on SMEs and that SME specific policies must be developed in a co-ordinated and logical manner, with the emphasis being on moving towards the development of appropriate medium to longer term SME tax policy.

As a guide, when setting tax policy for Australian SMEs, **it is recommended that further research and analysis be undertaken in relation to the following matters, amongst others:**

- **Lowering the overall tax burden.** Many OECD countries have lower corporate tax rates for small firms. As a general proposition, a company that pays a regular dividend to its shareholders owners/investors, irrespective of the stock price, will always be viewed favourably by prospective investors. This is equally true of both large and small companies. Shareholders reap the benefits of receiving cash dividends on a regular basis, and the presence of dividends will help support the market value of the company that is being built.

Accordingly, tax policy should assist SMEs maintain profitability whilst also easing cash flow burdens. In this regard, any proposed changes to the Dividend Imputation regime should take into account any adverse commercial and tax implications for SMEs.

- **More focused approach on developing appropriate SME tax strategies rather than tax compliance.** The tax system should be able to provide a framework to both encourage people to take the risk and start up a business, as well as providing further incentives along the way to those who succeed in their ventures. This involves having a more detailed understanding in relation to the composition of the SME sector, as well as the potential impact that changes in tax policy may have.

- **Increase investment tax incentives and initiatives for SMEs.** These types of initiatives more strongly influence SME investment decisions vis-à-vis larger businesses.

- **Encourage retention of taxable profits.** In this way, profits may be reinvested into the business by SME owners helping to establish a capital base, instead of using the monies personally. The implications for SME owner remuneration will need to be considered as part of this process.

- **Increase management and employee tax participation incentives.** In particular, increasing the tax free movement of capital when introducing new people into the business via share plans. Currently, this is stifled by Australia's CGT General Value Shifting provisions.

- **Allow small businesses access to a higher R & D concession rate.** As a general observation, whilst business spending on R & D has continued to rise over the seven year period to 2005-06, Australia still lags behind the OECD average R&D spend.

- **Increase simplicity in the tax law**. As previously discussed, any new tax laws introduced should adopt this as a fundamental principle. This has been lacking in Australia's changing tax landscape. This is also evidenced by the fact that Australian taxpayers are regarded as arguably the most tax agent dependent taxpayers in the world.

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In relation to the foregoing matters, we have also attached relevant articles by the writer which address each of the abovementioned issues in more detail. It is hoped that by taking into account the various submissions on small business and SME related issues, a more strategic approach will be adopted going forward in relation to the taxation of SMEs.

HLB Mann Judd

If you require any further information or assistance in respect of our submission, please contact Mr Mark Pizzacalla directly on (03) 9606 3843.

Yours sincerely

Mark Pizzacalla
Director

Attachment A - Australia's SME Tax Identity Crisis
Attachment B – Global SME Tax Policy Conundrum

Australia's SME tax identity crisis

Mark Pizzacalla*

Abstract

The Australian taxation landscape has never really come to terms with the concept of what it means to be a small business vis-à-vis small to medium sized businesses and larger businesses. Whilst various attempts have been made by successive governments to demonstrate that they have an understanding of what a small business is, tax initiatives in the SME sector have been ad-hoc and reactive in nature.

This article examines and evaluates the various approaches adopted in defining what is a small business in Australia, and concludes that there are too many and varied definitions of the term small business. This has contributed to policy makers failing to properly identify and target relevant tax concessions in this sector. The Federal Government's proposed legislation to standardise the eligibility criteria for small business tax concessions is a (small) step in the right direction. What is clear, is that a change in approach is well overdue.

* Mark Pizzacalla is the Head of Tax at HLB Mann Judd (Melbourne Office). The views expressed herein represent Mark Pizzacalla's own views and not those of HLB Mann Judd.
This paper was accepted for publication 8 February 2007.

1 Introduction

The terms 'small business' and 'small to medium sized enterprises' (SMEs) conjures up a variety of meanings in one's mind ranging from smaller owner operated businesses (including self-employed individuals) to larger privately run organisations. It is also not uncommon for a generic reference to be made to small business and SMEs by commentators and for such terms to be used interchangeably.[1]

Whatever definition is ultimately adopted to describe the small business/SME sector, there is universal agreement that taxpayers within this market segment are important to the Australian economy.[2] Broadly, using the most recent Australian Bureau of Statistics data for the 2000-01 year, the small business sector represented around 97% of all private sector businesses and employed around 3.6 million people.[3]

Notwithstanding this, it is arguable as to whether Australia's taxation regime does enough to encourage business activity in relation to the SME sector, or whether it really acts as an impediment thus inhibiting this sector's true growth potential.

It is submitted that the policy and conceptual framework of the Australian taxation regime, in relation to privately held SMEs, is biased against their establishment, continuation and growth.

Instances of systemic biases include, inter-alia, the following:

- An historical Government bias which has always perceived enterprises operating in the private sector to be non-compliant with taxation laws. Traditionally, successive Governments have generally viewed their activities with a high level of suspicion and mistrust resulting in this bias being reflected in a number of

1 Garry Payne, 'Problems with current tax concessions for Australian SMEs' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 83, 83-84.

2 Senate Economics References Committee, Parliament of Australia, *A Question of Balance: The Tax Treatment of Small Business* (1995) 1-5; Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) xv-xvii, 1-3; Peter Hendy, 'Threats to Small and Medium Sized Enterprises from Tax and other Regulations' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 17.

3 Australian Bureau of Statistics, *Small Business in Australia* (2001) Catalogue No.1321.0.

provisions in the Income Tax Assessment Act 1936 (ITAA 1936) and 1997 (ITAA 1997).[4]

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4 There are a number of reasons for this. Firstly, the SME sector has generally been less regulated and controlled compared to, say, ASX listed companies. Consequently, successive Governments have assumed that this category of taxpayer must be somehow "avoiding" tax due to, inter-alia, lack of public accountability.

Secondly, because of the SMEs' (smaller) size, it is assumed that such entities do not always comply with taxation laws given their lack of resources and funding. Thirdly, as SMEs are privately owned, this allows owners to have greater flexibility in the tax structures adopted to conduct their business, providing them, arguably, with greater scope to minimise their tax liabilities.

Consequently, and whilst not immediately apparent, this general view of SMEs has been reflected throughout the operation of the ITAA 1936 and 1997 respectively, where, for example, SMEs have been treated less favourably from a tax perspective in relation to a range of issues. Historically these have included, inter-alia, the following:

- pre-1986/7 income year, a private company was liable for additional tax (known as 'undistributed profits tax') if it failed to distribute a specified proportion of its after-tax income within a certain timeframe pursuant to Division 7 ITAA 1936. The rules operated such that if a "sufficient distribution" was made within 10 months of the end of the income year (broadly calculated as the company's after-tax income less a retention allowance that the company was permitted to retain), then there would be no undistributed profits tax applied. However, if the amount distributed was less than the "sufficient distribution", undistributed profits tax would be applied at the rate of 50% on the difference between the "sufficient distribution" amount and the lower amount actually distributed. The rationale behind this provision was to discourage private companies from retaining profits in their financial accounts effectively resulting in an indefinite deferral of tax which would otherwise have been paid at the shareholder level if such profits were distributed. Interestingly, this requirement did not apply to public companies nor to some non-resident private companies;
- further, a private company did not automatically qualify for a full rebate of tax on dividends received from other private companies (subparagraph 46(2)(a) ITAA 1936); and
- under the former subsection 80A(1), there were more stringent carry forward loss deduction tests where a private company had to *satisfy* the Commissioner of Taxation that the 'continuity of ownership' test requirements were met, whereas in relation to a public company, the Commissioner of Taxation only had to be satisfied that it was *reasonable to assume compliance* (former Subsection 80A(1) ITAA 1936 and Divisions 165-166 ITAA 1997 vis-à-vis Division 166-A ITAA 1997).

Current tax legislation includes, inter-alia, the following examples:

- more stringent pre-CGT asset rules applied under the former section 160ZZS (now Division 149 ITAA 1997) which "triggered" a CGT liability in cases where whilst there was no change, after 19 September 1985, in the direct ownership of an asset, there is a substantial change in the underlying beneficial interests of natural

- There has never been a clear definition of what is an SME so that appropriate tax policies can be properly developed and targeted to meet the requirements of this sector.[5]
- No clear tax policy on how SMEs should be taxed. Whilst it has been generally accepted in Australia's business community that the Howard Government's A New Tax System (ANTS) package (released in 1997), combined with the Ralph Review of Business Taxation (released in 1999), provided a platform for genuine tax reforms to occur, neither of these focussed specifically on the SME sector.[6]
- Lack of appropriate statistical data to assist the government of the day with policy decision making in relation to SMEs.[7]

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persons in the asset. This test was required to be satisfied at all times for private companies. However, in the case of public companies, normal stock exchange transactions in relation to the company's shares did not attract this provision if such sharetrading activity was not associated with a merger or take-over activity. This approach has since changed under the 1997 ITAA where public entities are now required to periodically test whether there has been a change in the majority underlying beneficial interests;

- a deduction may be denied in relation to excessive remuneration paid to shareholders/directors/associates of private companies (s109 ITAA 1936);
- certain payments made by private companies to associated persons may be treated as dividends and disallowed as a deduction (s108 ITAA 1936);
- distributions made to entities connected with a private company, such as shareholder loans and benefits (Division 7A ITAA 1936);
- application of the alienation of personal services income rules (Part 2-42 ITAA 1997); and
- more stringent bad debt deduction rules (subsection 63A(2) ITAA 1936 and Subdivision 165-C ITAA 1997 vis-à-vis Division 166-A ITAA 1997).

5 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 10-17.

6 Business Council of Australia, *Keeping a Permanent Watch on Australia's Tax System* (March 2006); Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 2.

7 Vince Mitchell, 'Managing Risks: The 'Small Business Income' Approach' (1997) 13 *Australian Tax Forum* 55, 65-9. In this article the author identifies various concerns in relation to identifying the composition of the small business sector from an ATO audit compliance perspective. In the author's view, the heterogeneity and volatility (in terms of entry and exit rates) of the small business sector creates considerable problems when attempts are made to estimate and rank the potential risk to revenue and what needs to be done about them. In 1997, the ATO's Small Business Income business line

- The manner in which SMEs are taxed quite often depends on their legal form, not size. This has always added an extra layer of complexity when formulating tax policy for this sector. [8]
- A failure on the part of major tax reform committees to properly consider SME tax issues as a subset of the overall tax reform process.[9] Arguably, some of the major reforms in Australia have generally had an adverse impact on SMEs.[10] By way of example, the Review of Business Taxation chaired by Mr John Ralph concluded that the introduction of GST, together with other reforms, would have an adverse impact in relation to the small business sector. The final report particularly mentions that sole proprietors and partnerships (because they are not taxed as companies) would not benefit from the reform process to the same extent as other industries from the reduction in the company tax rate. At the same time, such taxpayers were likely to incur increased compliance and reporting responsibilities (particularly under the GST regime).[11]
- The burden of tax compliance makes it difficult for SMEs to comply with the tax law,[12] and has been recognised in a recent OECD paper as the largest single component of the small business

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identified entities as a small business if they were reporting a revenue turnover of at least AUD$1 but less than AUD$10m.

8 Commonwealth, *Tax Reform: Not A New Tax, A New Tax System* (1998) 109-110. Whilst not directed specifically at SMEs, the Howard Government has recognised the problems and issues associated with the different tax treatment being afforded to the various entities and at the individual investor (eg shareholder) level, and has adopted the view that the same investment should not attract a different tax treatment simply because of the type of structure adopted (eg trust versus company). Notwithstanding, it is important to note that the Howard Government's attempt to introduce a standard 'entity' taxation regime was subsequently withdrawn.

9 Michael Dirkis and Brett Bondfield, 'The RBT ANTS Bite: Small Business the First Casualty' (2004) 19 *Australian Tax Reform* 107.

10 Binh Tran-Nam and John Glover, 'Tax Reform in Australia: Impacts of Tax Compliance Costs on Small Business' (2002) 5(3) *Journal of Australian Taxation* 338.

11 Commonwealth, Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable* (1999) 743-52.

12 Francis Chittenden, Saleema Kauser and Panikkos Poutziouris, 'Tax regulation and small business in the US, UK, Australia and New Zealand' (2003) February *International Small Business Journal* 1. Whilst there is significant literature on the cost of tax compliance for the small business sector, this represents the most recent writing in this area.

> regulatory burden.[13] During the mid-1990s, it was estimated that approximately 70 per cent of the cost to small business of complying with governance paperwork was associated with tax.[14] This prohibits SMEs to properly access and benefit from any targeted tax concessions made available to this sector.[15] In a recent Institute of Chartered Accountants of Australia survey, over 750 practitioners (around 93% of total respondents) indicated that the complexity of current tax legislation faced by small business was the number one priority that the Federal Government needs to address.[16] Consequently, it is not surprising to find that SMEs have generally viewed the Federal Government's policies as working against them.[17]

As a result of the above biases, SMEs have posed a real and significant challenge for taxation policy. Successive governments have promoted themselves as champions of SME businesses, however, one needs to question whether this is simply to win electoral favour.[18] The Prime Minister, Mr John Howard has described this sector as:

> the engine room of the Australian economy, a vital source of enterprise, innovation, and growth.[19]

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13 OECD, *Businesses' Views on Red Tape: Administrative and Regulatory Burdens on Small and Medium Sized Enterprises* (2001) 8.

14 Taxation Institute of Australia (Editorial), 'Think Small' (1995) 29(10) *Taxation in Australia* 514, 514-15.

15 Mark Pizzacalla, 'Small Business CGT Concessions and Related Trust Issues' (Paper presented at the Taxation Institute of Australia National Tax Intensive Retreat, Noosa, 17 August 2006). This paper considers the numerous difficulties and potential traps involved when SME taxpayers try to gain access to the small business CGT concessions.

16 Peter Switzer, 'Time for Costello to get serious about red tape', *The Australian* (Sydney), 5 September 2006, Finance, 1

17 Peter Graham, 'Small business participation in the global economy' (1996) 33(1) *European Journal of Marketing* 90, 93-94; Peter Hendy, 'Threats to Small and Medium Sized Enterprises from Tax and other Regulations' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 113.

18 Taxation Institute of Australia (Editorial), 'Small Change' (1996) 31(4) *Taxation in Australia* 174, 174-76.

19 Commonwealth, 'More Time for Business' (Statement by the Prime Minister, the Hon John Howard MP, 1997).

Accordingly, given the importance of SMEs to the Australian economy,[20] it is imperative to examine and more fully understand the impact that such biases have on the SME sector. The challenge lies in attempting to balance the interests of the State in ensuring proper and full compliance with taxation laws, and those of the enterprise in minimising compliance costs whilst ensuring the profitability and viability of the enterprise.

Whilst some commentators may argue that there is little or no empirical evidence to support the case for providing the small business sector with any tax concessions at all (other than for political gain),[21] others are in favour provided that any small business tax concessions introduced are also accompanied by appropriate policy rationale.[22] Whatever one's view, internationally, governments have increasingly shown interest in promoting an enterprise culture by fostering small business.[23]

The purpose of this article is to examine and evaluate the various approaches adopted in defining what is an SME in Australia, and the issues which this has created over the years for policy decision making in relation to the SME sector. This identification and classification of SMEs is critical so as to enable tax policy to be better implemented and concessions to be better targeted. The various biases referred to above have been exacerbated by the lack of a clear SME definition.

Recently, the Australian Government announced that it would introduce legislation to standardise the eligibility criteria for small business tax concessions effective 1 July 2007.[24] It is proposed that there will be a single definition of small business; being any business with an annual turnover of less than $2m.

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20 Senate Economics References Committee, Parliament of Australia, *A Question of Balance: The Tax Treatment of Small Business* (1995) 1-5; Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) xv-xvii, 1-3; Peter Hendy, 'Threats to Small and Medium Sized Enterprises from Tax and other Regulations' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 17.

21 Richard Krever, 'Taming Complexity in Australia Income Tax' (2003) 22 *Sydney Law Review*.

22 Mark Burton, 'The Australian Small Business Tax Concessions - Public Choice, Public Interest, or Public Folly?' (2006) (21) *Australian Tax Forum* 71, 73-74.

23 OECD, *Fostering Entrepreneurship* (1998); European Commission, *Recommendation of 25 May 1994 concerning the taxation of small and medium-sized enterprises* (1994) 94/390/EC.

24 Peter Costello, 'Making Tax Compliance Easier for Small Business - The New Small Business Framework' (Press Release, 13 November 2006).

The theory is that small businesses that qualify will only be required to apply one eligibility test to assess the range of small business concessions. Whilst this should result in a reduction in compliance costs, it is not entirely clear how this proposal will work in practice. For example, currently small business may access the small business CGT concessions provided inter-alia, that it meets the $5m maximum net asset value test. This is quite different to an annual turnover test. The Treasurer's press release does state that businesses with existing access to CGT, FBT or PAYG small business concessions will not lose out under the new arrangements. However, what this means in practice is that small business will still be required to review two sets of eligibility criteria (the new and the old).

Further no indication is given as to how the $2m annual turnover test was determined. It may be reasonable to conclude that this has been lifted from the recent ICAA report. More information is required from the Government in this regard for any objective analysis to take place.[25]

It is disconcerting that whilst the new measures are expected to be introduced in July 2007, treasury will not be seeking consultation on the changes until February 2007. Accordingly, whilst, prima-facie, this new development looks somewhat appealing, as always, the 'devil is in the detail'.

2 Criteria for Tax Reform

Some previous governments have accepted the view that the growth in government spending and in the overall burden of taxation should be curtailed.[26] Whether this is still the case or not today, the issue which continues to be relevant is how that overall amount of taxes should be raised and where that burden should lie amongst the various types of taxpayers.

The following observations made in the Hawke/Keating era continue to be just as relevant today:

> The Government shares the community view that the tax system should be fairer and be seen to be fair. The Australian taxation system traditionally has enjoyed broad taxpayer support but this has obviously waned over the past decade or so. The view is now widespread that the system operates unfairly, impairs economic incentives and is unduly complex. The system is

25 Karen Goodfellow, 'So you think you run a small business? Proposed changes raise questions' (2006) 49 *Weekly Tax Bulletin, 1952 – 1954.*

26 Commonwealth, *Reform of the Australian Tax System: An Overview* (1985) 1.

> particularly unfair to wage and salary earners at relatively moderate income levels who must pay tax at high marginal rates. Even at high income levels there is unfairness since people with comparable incomes can pay widely different amounts of tax because some are better situated to take advantage of generous tax concessions. The high rates of tax and a tax base riddled with concessions also impairs economic efficiency: it alters people's behaviour and directs resources from their most productive use in the economy. The complexity of the system is notorious. The costs that this complexity imposes on taxpayers and tax collectors alike are vexations to individuals and a dead-weight loss to the economy…
>
> Piecemeal improvements have been made to the system over the years but the point has not been reached where fundamental reforms – rather than further running repairs – are called for…[27]
>
> Chapter 1 of the draft White Paper identifies fairness (or equity), efficiency (or the need for taxes to be neutral in their effect on decisions to work, to save and to invest), and simplicity as the major criteria of tax reform. It notes that there will sometimes be conflicts among these (and other) criteria and that compromises will usually have to be struck.[28]

The above paragraph, whilst being relevant generally, also reflects concerns raised in SME circles. Whether an appropriate level of compromise has been reached when it comes to SME tax policy is debatable, but based on the available literature, arguably, it has not, especially in relation to the burden of compliance costs faced by SMEs whenever there are tax law changes.

Interestingly, the draft White Paper did not address SMEs as a separate sector of the taxpaying community, (although it did address specific issues which are common in the SME sector such as the taxation of trusts).[29] Nor was any specific mention made by the (former) Treasurer, Mr Paul Keating, in his paper which accompanied the 1985 tax reforms.[30]

It is generally accepted in tax literature that the essential criteria for assessing a tax system are equity, efficiency and simplicity, although there are also a number of other additional factors that may be considered when

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27 Ibid 1.

28 Ibid 3.

29 Commonwealth, *Reform of the Australian Tax System: Draft White paper* (1985) 52-7.

30 Paul Keating, *Reform of the Australian Taxation System: Statement by the Treasurer* (1985)

evaluating a tax system.[31] These design criteria were noted by the Australian Treasury in discussing the government's tax reform proposals (which were later introduced in the 1985 year). Whilst not addressed here, it is also accepted that not all commentators agree that these are necessarily the relevant criteria to be used.[32] Inevitably, the objectives of equity, efficiency and simplicity are quite often in conflict and a compromise must be struck. This usually means that various degrees of acceptability, when evaluating each objective, will only ever be achieved.[33] Ultimately, complexity in the law creates inequity.[34] By way of recent example, the complexity involved in accessing any of the small business CGT concessions is irrefutable.[35]

In trying to strike a compromise between the objectives of equity, efficiency, and simplicity given the nature and type of taxpayers operating in the SME sector, it is submitted that such objectives should be ranked in order of importance as follows: simplicity, equity and efficiency.

This conclusion is reached on the basis that the greater the complexity, the more difficult it is for SMEs to understand and access the various concessions potentially available to them. This naturally results in greater compliance costs being incurred by them when determining their eligibility, and assessing any potential benefits they may be able to access. The greater the complexity, the greater the need for the SME to have an (external) adviser analysing the legislation and making recommendations on its behalf.

The inability of government to strike this balance and the resulting adverse consequences is evident, for example, in the introduction of the Simplified Tax System (STS).[36] In a recent CPA Australia survey on issues surrounding small businesses, it was found that there was general confusion

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31 Commonwealth of Australia, *Reform of the Australian Tax System: Draft White paper* (1985) 14-17; Business Council of Australia, *Keeping a Permanent Watch on Australia's Tax System* (March 2006) 7.

32 Simon Blount, 'The Art of Taxation' (2001) (345) *Australian Tax Forum*; Graeme Cooper, Robert Deutsch and Richard Krever, Eds. *Income Taxation: Commentary and Materials 2nd Edition* (1993) 1-25.

33 For example, in trying to make the tax system more equitable, more complex legislation may be required.

34 Vince FitzGerald, The Allen Consulting Group, *Reform of Australia's Taxation System: Priorities and Directions* (1996) Paper No.46 8-9.

35 Richard Krever, 'Taming Complexity in Australia Income Tax' (2003) 22 *Sydney Law Review*.

36 Paul Kenny, 'A "Simplified Tax System" for Small Business' (2002) 6(1) *The Tax Specialist* 36.

amongst small business about the STS system. The main reason given by accountants and small businesses for not using the STS regime were that it was too complicated and of little value.[37] Similarly, the recent introduction of the Tax Consolidation regime has meant that it is likely that there are many SMEs which have not consolidated due to the complexity of the regime and the cost of seeking specialist advice in this area.[38]

Accordingly, by ensuring that tax legislation can be easily understood and applied, this gives SMEs greater certainty in the administration of their tax affairs.

Interestingly, in an ABS survey taken in the mid-1990s, it was found that whilst just over three quarters of small business make use of at least one source of external advice (ie usually comprising accountants, banks and solicitors), very few firms actually used 'specialist' external advisers.[39] It was also found that non-employing businesses were the least likely to seek external advice (compared to those businesses with 5-19 employees) preferring to rely on the use of government small business agencies presumably due to cost constraints.[40]

Other ABS surveys[41] have shown that firms which use external advice are more likely to be successful than those which don't. Arguably, SMEs will require more advice at the commencement phase of their business lifecycle, but this is also the time when they are most vulnerable as well as being subject to cost constraints.

In the context of the UK's Company Law Reform process in the late 1990s, four tests have been suggested to evaluate proposals for reform such that there were some benchmarks against which they could be measured, as follows:[42]

(i) Accessible, comprehensible and comprehensive legislation
As a general proposition, larger firms have access to more qualified in-house staff whilst smaller firms need to seek external advice if

37 CPA Australia, *Small Business Survey: Compliance Burden* (2006).

38 Communication from Mr John de Wijn QC to Mr Dick Warburton, 27 February 2006.

39 Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 69.

40 Ibid.

41 Ibid.

42 Judith Freedman, 'One Size Fits All - Small Business and Competitive Legal Forms' (2003) 3(1) *Journal of Corporate Law Studies* 123,131-34.

provisions are unclear. This is the classic example of where costs are regressive in nature for SMEs vis-à-vis larger businesses.

(ii) Avoidance of artificial steps and barriers
The use of different thresholds for different concessions/ exemptions can lead to confusion and increased costs, as well as acting as a reason for business owners to avoid growth if they believe it will result in a net loss of benefits accruing to them.

(iii) Reduction of unnecessary burdens without introducing 'complex deregulation'
Administrative requirements should be kept to a minimum so as to reduce the need for costly decision making.

(iv) Reduction of unnecessary burdens whilst maintaining protection from third parties and minorities
Not relevant here in a tax sense, but this focuses on ensuring that third parties and minorities are not adversely impacted by any relaxations and exemptions from burdens.

Similarly, in a recent review of tax compliance costs undertaken in New Zealand, it was acknowledged that key guiding principles in relation to tax simplification include, inter-alia, the following:

- Tax rules should have empathy with good business practice.
- There should be common approaches to problems between taxpayer classes and tax types.
- Existing tax systems should be used for any new taxes.
- Thresholds should be justified.
- Taxpayers should generally be able to understand and fulfil their own obligations with minimal outside (external) help and without fear of making errors.43

However, the review found that one of the main reasons for increasing complexity and burgeoning amount of tax law were from purist views that emphasised the maintenance of the tax base above all other tax policy objectives.[44]

43 Ministry of Economics Development of New Zealand, *Finding the Balance-Maximising Compliance at Minimum Cost* (2001) 119.

44 Ibid 135.

The foregoing literature and surveys (amongst others) supports the view that SME tax concessions should first, and foremost, follow the principle of 'simplicity'. Ideally, this can only be achieved if tax legislation can be easily understood by SMEs, the benefits clearly demonstrable and calculable, and with minimum external specialist advice required by them for its implementation.

3 Identification of SMEs in Australia

To ask the question 'what is an SME?' inevitably leads to the more important question of 'what is meant by small, medium and large enterprise?' This may also beg the question 'what is meant by the term enterprise?'

It is submitted that this is a key issue because it is not possible to postulate as to the appropriate SME tax policies without a clear, discernable and generally accepted position as to the kind of taxpayer at which such policies are directed. It is critical to begin such a discussion with an agreed position as to the nature and type of taxpayer that you are formulating tax policies for?

There has been a significant amount of literature on how a small business should be defined[45] and the different types of definitions currently in use for tax purposes, as well as for other purposes.[46]

What is clear is that all of the various definitions adopted in such literature focus on both quantitative measures (eg turnover, assets, number of employees, capitalisation or legal status) and qualitative factors (eg management and organisational characteristics such as owner control and operation).

As part of this process, it has been recognised that a compounding problem for policy makers in relation to this area is that there is no definitive interpretation of the meaning of the expression "small business". [47]

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45 Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 7-24.

46 Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001) 23-27; Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 11-15.

47 Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001) 8; Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 7-24; Guy Brandon, 'One person's small business is another government instrumentality's' (Speech delivered at the Taxation Institute of Australia Small Business Intensive, Fremantle, 29 October 2004).

The weight of argument would seem to be in favour of adopting a quantitative approach. This proposition is recognised by Professor Scott Holmes in his research where it was concluded that:

> qualitative characteristics are by definition difficult to readily measure as a basis for categorising a group of firms. This has led to most definitions having two parts: Qualitative statement of the key characteristics of a small firm; and a quantitative proxy, such as turnover, number of employees or value of assets. Definitions adopted by researchers and for the purpose of government and related inquiry have tended to adopt the traditional two component definition, while for legislative and policy purposes there tends to be a simple statement of a "cut-off" based on a quantitative measure. Legislators seek to capture a certain group of businesses and normally this involves a fairly unrefined and broad based approach. It must be accepted that these definitions are not necessarily about defining small firms, but about application to a target group for specified purposes. As such, the definitions used in legislation are an inherently bad guide as to the most appropriate universal definition of small business.[48]

The diverse nature of the types of entities which operate in the small business sector inevitably means that to find an all encompassing definition of 'small business' which everybody agrees on is difficult, if not impossible.

The adoption of any definition either based solely on quantitative or qualitative factors, or a combination of both, will always inherently be flawed in some way. Accordingly, it is submitted that one must accept that only a quantitative based definition can really provide a practical, clear and concise delineation between small and larger businesses, for policy making purposes.[49] This does not mean that different definitions cannot be used for more targeted 'one-off' small business concessions. What it does mean, however, is that the concept of 'simplicity' demands a definition that both

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48 Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001) 17-18.

49 For example, the Small Business Act (SBA) in the US which was established to aid, counsel and protect small business concerns defined a small business to be one that is independently owned and operated and which is not dominant in its field of operation. However, the definition also includes a numerical definition which varies on an industry-by-industry basis to establish eligibility for SBA programs. This is referred to as the 'Size Standard' and is almost always stated in either number of employees or average annual receipts. Refer the *US Code of Regulations* Title 13, Part 12.1.

policy makers and taxpayers can easily understand and rely upon in their decision making process.

This type of definition has been coined by others as a 'one size fits all' approach where it has been argued that given the variety, and dynamic nature of the small business sector, this is preferred to the tailoring of specific definitions for different types of small businesses.[50] It is argued that this approach avoids the creation of artificial and problematic distinctions which could create, rather than remove, barriers to growth.[51] Ultimately, it is submitted that a practical approach is required.

The following is a summary of the types of definitions used for 'small business' in Australia. These definitions are analysed with a view to establishing a clearer pathway going forward as to what is required in terms of having an appropriate SME definition for tax purposes.

3.1 Australian Bureau of Statistics definition

The most quoted definition of "small business" in Australia is that used by the Australian Bureau of Statistics (ABS) which defines "small business" based on the number of employees. For ABS purposes, a "small business" is defined as businesses employing less than 20 people (or a manufacturing business employing less than 100 people), but excluding agriculture[52] (this is excluded on the basis that agricultural businesses can have large scale operations with relatively few or no permanent employees, using large numbers of seasonal and itinerant workers to satisfy short-term labour needs).[53]

The ABS definition then redefines this to include the following categories:

- non-employing businesses (sole proprietorships and partnerships without employees);

50 Judith Freedman, 'One Size Fits All - Small Business and Competitive Legal Forms' (2003) 3(1) *Journal of Corporate Law Studies* 123.

51 Ibid 125.

52 Australian Bureau of Statistics, *Small Business in Australia* (2001) Catalogue No.1321.0. For ABS statistical purposes, in relation to agriculture, a different measure is used known as the Estimated Value of Agricultural operations (EVAO) which is based on the area of crops sown, number of livestock, and crops produced/livestock sales during the year. A small agricultural business is defined as one having an EVAO of between $22,500 and $400,000.

53 http://www.abs.gov.au/Ausstats/abs.

- micro-businesses (businesses employing less than 5 people, including non-employing businesses); and
- other small businesses (5-19 people).

For completeness, the ABS defines:

- "medium businesses" as those employing 20-199 people; and
- "large businesses" as those employing 200 or more people.

For the 2000-01 year, using the above ABS definition, there were 1,233,200 private sector small businesses in Australia which represented 97% of all private sector businesses, employing around 3.6m people, and comprising 49% of all private sector employment. [54]

It should be noted that the ABS Report, "Small Business in Australia" (cat.1321.0) reference document was first released in 1988 to meet a strong demand for small business related data. However, this publication has not been updated since 2001. Accordingly, other ABS publications have been referred to for more current information on small businesses operating in Australia. However, whilst the ABS has published other publications with references to "small business", caution needs to be exercised when making comparisons as each publication provides a profile of business demographics from a different perspective. For example, the definition of a small business in Experimental Estimates, Regional Small Business Statistics is based on a combination of income and expenses. As a result, businesses referred to in this publication with total income and/or expenses between $10,000 and $5m are classified as small. [55]

Further, whilst the ABS has published, for example, the "Characteristics of Small Business Operators Survey" (cat.8127.0) document, this is a households' survey, as opposed to a business based survey, and so has not been used here as a comparative document. [56]

Notwithstanding these limitations, the 2004 survey results indicated that there were an estimated 1,270,000 small businesses operating in Australia as at June 2004 comprised as follows:

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54 Australian Bureau of Statistics, *Small Business in Australia* (2001) Catalogue No.1321.0.

55 Data in this publication are sourced from the ATO Business Income Tax file which includes all businesses who have traded at any point during the year. For the purposes of this publication, the statistical unit is the legal entity.

56 This is on the basis that variations will occur because of differing data sources, statistical units, scope and coverage of definitions between surveys, as well as variations due to sampling and non-sampling errors.

SME Category	No. of Businesses
Non-employing businesses	715,000 (56.3%)
Micro-businesses (employed 1 – 4 people)	416,000 (32.8%)
Other small businesses (employed 5 – 19 people)	139,000 (10.9%)

Source: Australian Bureau of Statistics, *Characteristics of Small Business (Reissue)*, Cat.No.8127.0 (2004).

This same survey indicated that 67.5% of all small businesses were home based (1997: 58.3%) operated by 1,040,000 people which represented 62.6% of all small business operators. 57

Some papers have criticised the usefulness of the ABS definition on the basis that it does not take into account the considerable diversity of businesses within the SME group.[58] It is argued by some commentators that effective policy making needs to use the appropriate size threshold for the problem at hand as small business will vary depending on various factors including nature of activities, age and expected growth.

It is submitted that whilst one has empathy for this view, it would be difficult to achieve in practice given the lack of statistical data and the continuous movement of businesses entering and exiting the SME/small business sector. Further, the ABS Business Longitudinal Study (2000) research,[59] which supports employment as being the most appropriate variable for determining business size boundaries, is the only one of its kind which has attempted to link qualitative elements of a small business with the most appropriate quantitative proxy.[60] Accordingly, the ABS definition should not be easily discounted and provides a definition of small business which can be readily understood and applied in practice.

Indeed, when setting the general practice in relation to small business policy and programs, it is argued by some commentators that one should

57 It is important to note that in the first edition of this survey in 1995, a "home based business" was defined as one where "one or more of the operators of the business worked more hours at home than away from home". However, in 2004, it was defined as one where "most of the work of the business was carried out at the home(s) of the operator(s) or where the business has no other premises owned or rented other than the home(s) of the operator(s). Accordingly, whilst the definitions are similar, they are not strictly comparable. Therefore, caution needs to be exercised when making these sorts of comparisons.

58 Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) xv-xvi.

59 Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001) 8.

60 Ibid 18.

not try to use a common definition of small business across all topics. This is because in different contexts, there may be different answers to the question of which businesses are sufficiently different from other (larger) businesses to require special consideration.[61]

The ABS definition of "small business" does confirm the importance of this sector to the Australian economy. However, the statistics also seem to support the proposition that, by and large, small businesses remain small,[62] and that the growth in small business employment is mostly due to a few rapidly-growing small firms, otherwise referred to in some literature as – 'gazelles'.[63]

Why is this important? If this is confirmed to be the case, then, arguably, tax policy for the small business sector should take this into account. It may well be that a distinction is required to be made from a tax policy perspective for small businesses vis-à-vis medium and larger businesses. This is consistent with observations made by other commentators in relation to certain overseas jurisdictions such as the UK.[64] Whilst this argument has some merit, the testing of this contention is outside the scope of this article.

3.2 ATO classifications and compliance issues

The ATO's audit activities were largely generic in nature until 1988 when their audit operations were restructured into three separate and distinct business lines: Complex Audit, Business Audit and Primary Audit.[65] This largely mirrored how the ATO viewed taxpayer populations at that time: large corporations, small and medium businesses, and non-business individuals.

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61 Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 3.

62 Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001) 2-4; Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) xvi; Judith Freedman, 'One Size Fits All - Small Business and Competitive Legal Forms' (2003) 3(1) *Journal of Corporate Law Studies* 123, 126.

63 Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) xvi.

64 Judith Freedman, 'One Size Fits All - Small Business and Competitive Legal Forms' (2003) 3(1) *Journal of Corporate Law Studies* 123, 125-26.

65 Vince Mitchell, 'Managing Risks: The 'Small Business Income' Approach' (1997) 13 *Australian Tax Forum* 55, 58-59.

It was not until another 7 years had passed that the ATO formally acknowledged the significance of the small business sector,[66] and under a major re-organisation, established the "Small Business Income" (SBI) business line.[67] At this time, the ATO defined the Small Business sector to include all those entities (ie including sole traders, partnerships, trusts and companies) in receipt of business income of up to $10m. In 1993/94, this represented around 1.6m taxpayers.[68]

It is important to note that it was only since the formation of the SBI that the ATO started to collect data in relation to the small business sector. Such data was then presented in a joint ATO/Treasury Submission to the Senate Economics References Committee (which was established to review the tax treatment of small business). The ATO data was based on tax returns lodged, and showed that there were 1,662,188 entities that met this criteria in the 1993 income year, of which 1,230,830 (74%) were individuals or partnerships.[69]

The lack of such critical data inevitably meant that there were going to be issues with audit program design and delivery. However, the important point here is that similarly, and by definition, this also meant that it was going to be difficult to formulate tax policy in relation to a specific group of taxpayers for which little (if any) statistical data was readily available.

Upon realising the importance of the SME sector to the ATO's revenue collection, over time, the ATO has established a more considered profile for SMEs and its various sub-sets (for example, micro-businesses).

The ATO now defines an SME to be an enterprise with an annual turnover of between $2m - $100m, and a micro-business as those with an annual turnover of less than $2m. For completeness, the ATO defines large business groups as those with a turnover of $100m or more.[70] The other two market segments identified by the ATO are individuals and the Government and not-for-profit sector.

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66 Taxation Institute of Australia (Editorial), 'Think Small' (1995) 29(10) *Taxation in Australia* 514, 515.

67 Vince Mitchell, 'Managing Risks: The 'Small Business Income' Approach' (1997) 13 *Australian Tax Forum* 55, 56-57.

68 Ibid.

69 Senate Economics References Committee, Parliament of Australia, *A Question of Balance: The Tax Treatment of Small Business* (1995) 1-5.

70 Commonwealth, Australian Taxation Office, *Updated Compliance Program 2005-06* (2005).

The ATO has recognised that the characteristics of an SME can vary significantly depending on both their size and complexity. Through its Compliance Program, the ATO has identified the following characteristics in relation to the SME sector:[71]

- 85,000 enterprises, consisting of 72,600 single entities and 12,400 groups (with 42,000 members).
- Employ 1.8m people.
- 7,800 self managed superannuation funds included in this sector.
- More than 83% of these enterprises have a turnover of less than $10m, with the majority using a simple business structure (eg company).
- Those at the higher turnover levels often have multiple entities (91% of these are in a corporate group) and may include off-shore entities.
- 20% of businesses in the $50 - $100m turnover range are public companies.

Through its Compliance Program, the ATO has identified the following characteristics in relation to the micro-business sector:[72]

- Includes small superannuation funds with assets of less than $2m.
- There are 2.3m micro-businesses which account for 96% of all business in the revenue system (including 300,000 small superannuation funds and 200,000 trusts).
- Over 60% of these businesses are in property and business services, construction services, primary production, and retail.
- Most have a simple business structure with around 60% operating as sole traders or partnerships.

Interestingly, the ATO Compliance Program 2003-04[73] indicates that around 80% of micro-businesses have an annual turnover of less than $200,000 mostly comprising family run businesses with few or no employees, with a sole trader or family partnership structure, and operating from home. The ATO recognises that micro-businesses, in particular, incur significant opportunity costs associated with tax compliance as this takes them away

71 Ibid 29.
72 Ibid 16.
73 Commonwealth, Australian Taxation Office, *Compliance Program 2003-04* (2003).

from their income-earning activities. It is well documented that this occurs primarily due to a lack of in-house accounting and tax experience.[74]

In the ATO's Compliance Program 2004-05, it was stated that:

> Small to medium businesses display different characteristics depending on their size and complexity. Over 85% of these businesses have a turnover of less than $10 million, use simple business structures and are typically single entity companies. Businesses with a turnover of more than $10 million are likely to be more sophisticated and often involve a number of related entities, including offshore entities. Public companies comprise 20% of businesses in the $50 million to $100 million turnover range, compared to only 1.7% in the $2 million to $10 million range.
>
> Small to medium businesses employ 1.6 million people, and approximately 50% of the tax revenue from these businesses is PAYG withholding tax. About 26% of tax revenue is GST from the sale of goods and services to their customers. They contribute approximately 19% of income tax, 31% of GST, 20% of fringe benefits tax, 0.5% of excise duty and 24% of wine equalisation tax.[75]

It also indicated that:

> Generally, small to medium businesses comply well with routine business transactions and events, including registering and lodging forms such as activity statements and income tax returns. However, some small to medium businesses and agents find more complex areas of the law a challenge, particularly for one-off or unusual transactions such as mergers, acquisitions and disposal of assets.
>
> Some small to medium enterprises, usually with a turnover of more than $50 million, are beginning to mirror many of the tax planning features characteristic of large businesses. So we are shifting our approach, adopting the risk identification processes and strategies we use for large businesses to address compliance issues. This includes assessing the overall income tax performance of business against economic performance.[76]

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74 Ibid 12.

75 Commonwealth, Australian Taxation Office, *Compliance Program 2004-05* (2004) 18.

76 Ibid.

Based on comments made in the ATO's audit compliance program, an SME starts to lose its SME characteristics or qualities where the annual turnover is around $50m or more.

Whilst not definitive, therefore, the ATO's documented position in relation to tax audits is one indicator that suggests any concessions targeted at SMEs should be restricted to those entities with a turnover of less than $50m. This is assuming that a "turnover" test would be used as one of the definitions for determining SME status.

The importance of both the SME sector and the micro-business sector to Commonwealth revenue is obvious as, together, these sectors contribute around 23% of net Tax Office collections (comprised as follows: SMEs 11%, micro-businesses 12%).[77] The Commonwealth's revenue generated from these sectors in recent years is summarised at **Appendix 1**. What is clear is that income tax comprises the majority of the "tax take".

Whilst the ATO have split their audit activities into the different sectors (as described above), they have learnt that, quite often, complex tax issues affecting the large business sector are equally as relevant for the SME sector. In an address given by Mr Michael Carmody, the former Commissioner of Taxation, when discussing the ATO's Compliance Program 2003-04, he made the following statement:

> What is clear from the 2003-04 Compliance Program is that these issues are just as relevant for many medium-sized businesses whose turnover is high but below the $100 million threshold we use to classify large businesses.
>
> This year we are increasing our focus on this segment.
>
> We have commenced applying the sophisticated economic and tax performance analysis used in the large corporate segment, with preliminary analysis pointing to similar results.
>
> As a result, 820 detailed risk reviews are planned this year, with compliance action being determined by the results of those reviews.
>
> We will be taking our learnings and experience in managing large corporate compliance and applying it to better managing compliance in the medium-sized business market.

77 Commonwealth, Australian Taxation Office, *Updated Compliance Program 2005-06* (2005) 16, 29.

> To achieve this, our experts from large business will share their experience and expertise with our people working in the small to medium market.
>
> This program will be progressively built up over the coming years.[78]

This demonstrates that the ATO, at the most senior of levels, is aware that a number of tax issues which impact large business also impacts SMEs who generally do not have in-house accounting and tax expertise to properly deal with the issues. This inevitably means that such tax issues require external advisors to address them for the SMEs resulting in increased compliance costs ("hard costs") as well as missed opportunity costs for the business owners.

This revelation by the ATO has resulted in a "shift" of ATO audit compliance focus to businesses with a turnover of between $50m - $100m in the SME sector.[79]

The ATO concedes that:

- Many SMEs rely on their tax agents for more complex tax advice, whilst managing "in-house" the more routine (compliance) issues.
- SMEs, particularly at the lower turnover levels, generally do not have access to the same resources (as large business) even though they are dealing with issues that are just as complex.[80]

What becomes clear when reading through the ATO's Compliance Program, over recent years, is that:

- there is explicit acknowledgment by the ATO that there is a tax bias against SMEs as they are trying to understand and implement new complex tax legislation (eg the introduction of the demergers and tax consolidation provisions) vis-à-vis large business;
- when dealing with complex tax issues, the opportunity cost for SMEs ultimately means that there is a resultant decline in their income generating activities;
- this has implicitly led the ATO to redefine the meaning of SME even further as evidenced by greater emphasis of ATO audit activity in the $50m - $100m turnover range. This

78 Michael Carmody, 'Managing Compliance' (Speech delivered at the Sydney Institute, Sydney, 18 August 2003).

79 Commonwealth, Australian Taxation Office, *Updated Compliance Program 2005-06* (2005) 31.

80 Ibid 30.

market segmentation approach by the ATO culminated in the appointment of Mr Kevin Fitzpatrick to a similar role as Deputy Commissioner Large and Medium Bsuiness (Care Leadership). His role is to focus on cases in the SME market where turnover is greater than $50m[81]. This is in recognition of the fact that some SMEs, particularly those with a turnover of more than $50m, are starting to "mirror" many of the tax planning features characteristic of large businesses.

3.3 ITAA Definitions of SME

This lack of understanding by the ATO as to what an SME is, seems also to be present in government circles, which has led to a myriad of definitions used for the purposes of various small business tax concessions introduced in the ITAA 1936 and 1997, the Fringe Benefits Tax Assessment Act 1986, and the A New Tax System (Goods and Services Tax) Act 1999.[82]

A review of the varying definitions used leads the writer to make a number of observations:

- there is currently no standard definition for the term "small business" or "SME" for tax purposes;
- varying qualifying criteria are used to enable taxpayers to access the different types of small business tax concessions with little or no consistency;
- such qualifying criteria is usually based on either level of assets or turnover (or both), however, such criteria used are defined differently depending on the tax concession being accessed, thus resulting in inconsistencies; and
- there are significant complexities associated with applying the criteria to the entity trying to access the small business tax concessions as it may also require an analysis of related entities (for anti-avoidance purposes to prevent a splitting of business activities by taxpayers so as to gain access to such concessions).

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81 J Killaly, 'Review of topical tax issues affecting corporate Australia' (Speech delivered at the The Australian Taxation Summit, Sydney, 7-9 February 2005).

82 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 9-15; Garry Payne, 'Problems with current tax concessions for Australian SMEs' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 83, 84-87.

Whilst the above issues have been well documented in the past,[83] perhaps the most interesting point which comes out is that most of the small business tax concessions are aimed at "small" businesses and not medium sized businesses (based on the ATO definition of SME).

So once again, we are left in a quandary as to what is a "small business" vis-à-vis large business. In this regard, it has been observed that most small business operators would not regard themselves as "small" once turnover was approaching $2m.[84] However, in practice, it is the writer's observation that business operators do not necessarily focus on gross turnover as a benchmark as to whether they operate a small business. Indeed, the writer has acted for a number of taxpayers whose gross turnover exceeds $10m, yet they do not consider themselves to fall into the category of anything other than a "small business". Usually, such a view is arrived at by the business owner based on the net profit and cashflow of the business. Whether or not such arguments are capable of withstanding objective scrutiny or should be discarded as simply being emotive based, the reality is that this overriding sentiment has been expressed to the writer several times in practice.

3.4 ICAA RESEARCH

In February 2006, the Institute of Chartered Accountants in Australia (ICAA) released a report (ICAA report) which reviewed the manner in which "small business" is defined for the purposes of Australia's Commonwealth income tax regime (including CGT, FBT and GST legislation).[85] The ICAA report was solely focussed on trying to make access to the small business concessions as consistent as possible, and reducing compliance costs through consolidating and simplifying the definition of small business.[86]

The ICAA report concluded that "turnover" should be used as the main criterion for access to small business concessions on the basis that this should result in minimal upheaval from the existing position, having regard

83 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 9-15; Garry Payne, 'Problems with current tax concessions for Australian SMEs' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 83, 84-87.

84 Garry Payne, 'Problems with current tax concessions for Australian SMEs' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 83, 86.

85 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 3.

86 It should be noted that this report did not discuss whether such small business concessions should exist, or whether new concessions should be introduced.

to the advantages and disadvantages of using different criteria, a desirability of marrying the income tax and GST systems wherever possible to reduce compliance costs and increase familiarity, and taking into account the number of concessions to which it can be applied and the ease of application.[87]

However, given that an 'assets' test is also currently in use for certain concessions (for example, the STS and small business CGT concessions), the ICAA report indicated that this should also be accommodated in any proposed changes as the policy reasons for the assets test meant that it was unlikely to be abandoned.[88]

The ICAA report recommended that a small business should be defined as one which has:

- a turnover of less than $2m (and linked to the GST meaning of turnover, calculated on a GST exclusive basis and excluding infrequent large capital asset sales); and
- assets of less than $6m (based on the market value of such assets less liabilities determined at the end of the financial year).[89]

The ICAA recommended that such thresholds be further examined to determine whether they should be subject to automatic indexation.[90]

The ICAA report also concluded that an "assets" test should continue to be used on the basis that it is unlikely the government will change its policy in relation to the two small business concessions that currently have an "assets" test (namely, the STS and small business CGT concessions).

Based on the literature in this area, one would agree with the ICAA report's conclusion that minimising the number of criteria used to define a "small business" would help to achieve the goal of simplicity. This is also consistent with the writer's view that this is the most important tax criteria to be satisfied when formulating tax policy for SMEs.

However, the ICAA report's recommendation that a $2m threshold (for turnover) and $6m threshold (for assets) be used does not fully explain the basis as to how such thresholds were reached. In relation to the turnover threshold, the ICAA report makes the observation that, ultimately, the

87 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 24.

88 Ibid.

89 Ibid.

90 Ibid 26.

precise threshold is a policy decision and, in any event, does not impact upon the prime goal of a simplified definition. In relation to the assets threshold, the ICAA report recommends that $6m is appropriate as it represents an increase from the existing $5m threshold to reflect that it has not been reviewed for some time.[91] The ICAA report concludes that this is not critical from the point of view of simplification.

Notwithstanding, it is accepted that the ICAA's brief to the authors was to take into account the current constraints of policy aims and provisions, and that this may have affected the authors recommendations. It would appear that the principal focus and objective of the ICAA report was to determine ways, and promoting discussion, about how to simplify the small business definition rather than having the focus on a quantitative measure. This is consistent with comments made in the executive summary of the ICAA report which states that:

> Precise thresholds for turnover and assets are a policy decision and do not impact upon, nor should they be used as a diversion from, the prime goal of a simplified definition. Hence, while the report suggests and uses a basic turnover threshold of $2m and an assets threshold of $6m in drafting a sample proposed new definition, the suggested form of this definition allows for deviations and perhaps higher thresholds for other concessions where justified.[92]

The ICAA report clearly summarises the lack of consistency in the adoption of criteria and thresholds used to either limit access to tax concessions, or to provide preferential treatment based on size.[93]

The ICAA report serves as a timely reminder that more thought is required from a policy perspective when determining the rationale for the introduction of 'sized based' business tax concessions.

3.5 SME Definitions Used in the Tax Reform Process

The difficulties associated with identifying a 'small business' as a separate and distinct category of taxpayer was recognized as early as 1990 in a report from the House of Representatives Standing Committee on Industry,

91 Ibid 25.
92 Ibid 5.
93 Ibid 9.

Science and Technology (the Beddall Report).[94] In the Beddall Report, it referred to the term 'small business' as having an 'identity crisis' where there is a conflict between what one generally understands a small business to be and a quantitative (or size) qualification to the small business definition.[95] It was also recognized that even if you established an agreed 'small business' definition, that this would only be the beginning of the process with extensive research being required to discover:

> the importance of small business in the economy, the opportunities it provides, and the difficulties it faces. Such research depends upon the collection of reliable and comprehensive data about small businesses.[96]

A number of recommendations were made in the Beddall Report for Government consideration.[97] In the end, the Beddall Report concluded that a small business was one which employed up to 20 people (in non-manufacturing industries) and 100 people (in manufacturing industries).[98]

During the course of its inquiry, the Beddall Committee revealed that the area of greatest regulatory concern to small business was taxation, particularly

> the rapid growth in the size and complexity of taxation law, the complex and often apparently uncoordinated administrative systems which support it, and the associated compliance and reporting costs which are particularly onerous for small business.[99]

The Beddall Committee noted that this results in a disproportionate impact on small business due to:

- economies of scale; and
- the inability of many owner operated businesses to bring the costs of taxation compliance to account as a tax deduction against income (ie smaller businesses do not generally have an "in-house" accountant and so need to weigh up the opportunity costs of

94 House of Representatives Standing Committee on Industry Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990).

95 Ibid xiii.

96 Ibid xiv.

97 Ibid xxix-xviii.

98 Ibid xiii.

99 Ibid xxix.

> management performing this function vis-à-vis loss of potential earnings (if the time was spent on the business) and opportunities lost (for business expansion and development).[100] This point was also acknowledged, some years later, by the Small Business Deregulation Task Force (Bell Task Force).[101]

When tax laws are introduced which do not differentiate between small, medium and large business, the direct effect is that the compliance burden of 'coming to grips' with the new provisions will fall disproportionately on the SME/small business sector. Whilst the introduction of Regulation Impact Statements has gone some way to ameliorating government decision making process, there is still room for improvement.[102]

Subsequent to the Beddall Committee's review, the tax treatment of small business was then considered by the Senate Economics References Committee (SERC) which found that, five years on, whilst some of the recommendations of the Beddall Committee benefited small business, some of the tax problems they faced remained essentially unchanged.[103] It would seem that a number of these issues are just as much a concern today as they were then.

Importantly the SERC acknowledged that the

> relative advantage enjoyed by larger businesses in using economies of scale and associated tax deductions to cope with compliance costs and tax imposts should be balanced to some extent by certain concessions to small business.[104]

For the purposes of the SERC report, the definition of small business employed by the ABS was used. This report did not comment on the definition of small business itself, nor whether such definition needed refining, but rather focused on making recommendations on relevant tax

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100 Ibid xxix.

101 Small Business Deregulation Task Force, Commonwealth of Australia, *Time for Business* (1996) 28.

102 Peter Hendy, 'Threats to Small and Medium Sized Enterprises from Tax and other Regulations' (Speech delivered at the Small Business Tax Symposium, Developing Good Tax Policies for SMEs, Sydney, 22 August 2003) 11-12.

103 Senate Economics References Committee, Parliament of Australia, *A Question of Balance: The Tax Treatment of Small Business* (1995) 1-5.

104 Ibid 14.

issues to counter the disadvantages faced by small business in complying with tax laws.

Soon after, the Small Business Deregulation Task Force (Bell Task Force) was established to, inter-alia, review the compliance and paper burden imposed on small businesses, and the options available to reduce such burden.[105] For the purposes of its inquiry, the Bell Task Force defined a "small business" as:

- independently owned and operated;
- most, if not all, capital contributed by owners and managers;
- closely controlled by owner/managers who make principal decisions; and
- having turnover of less than $10 million.

Most small businesses have less than 20 employees in non-manufacturing industries and less than 100 employees in manufacturing industries.[106]

The Bell Task Force's role was not to explore the definition of small business, but rather to focus on the paperwork and compliance burden on small business. It found that:

> the taxation system is too complex and expensive in terms of the number of taxes, the complexity and associated uncertainty of the law, the frequency of changes, the difficulty of interpretation and the costs of compliance.[107]

It is submitted that whilst there were three reviews conducted in relation to the small business sector over a six year period, no attention was given to the meaning of small business, even though back in 1990 it was made clear in the Beddall Report that this sector was experiencing an "identity crisis".

Worse still, the Bell Task Force was asked by the Government to only advise on

> revenue-neutral ways to halve the paperwork and compliance burden on small business.[108]

This led the Bell Task Force to concede that the

105 Small Business Deregulation Task Force, Commonwealth of Australia, *Time for Business* (1996) 89 vii.

106 Ibid 14.

107 Ibid 28.

108 Ibid 12.

> need to maintain revenue-neutrality and not consider taxation policy limited the scope and nature of the recommendations.[109]

And that

> previous efforts to reduce compliance costs have had mixed success and many in the small business community are cynical about this current effort.[110]

Tax proposals introduced since the Bell Task Force have all, to some extent, failed to deliver optimal outcomes for the SME sector including:

- ANTS reform package (which did not properly address the compliance cost impact on small business);
- the Ralph Review[111] (which failed to meet its stated objective of reducing compliance costs for small business);
- the introduction of various small business concessions which are complex and difficult to interpret and apply (including the Simplified Tax System and the Small Business CGT concessions);[112]
- introduction of integrity measures such as the personal services income rules (specifically targeted at small contractors) and non-commercial loss provisions (specifically targeted at small start up ventures) which added to the already increasing compliance burden on the small business sector;
- introduction of the Tax Consolidation regime (effective 1 July 2002) which meant that if small wholly owned groups did not consolidate, they would not be able to benefit from the inter-corporate dividend rebate provisions, loss transfers between group companies, and CGT roll-overs for asset transfers between group companies; and
- introduction of the new capital allowances regime (forcing small business to re-educate themselves on a traditional area of tax law).

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109 Ibid 12.

110 Ibid 14.

111 Michael Dirkis, Tax Institute of Australia, *Taxation Reform for Small Business* (October 2000) 132-41.

112 Ibid 113.

It was not until November 2003 that a new national small business consultative body was established to advise on the broad range of issues affecting the small business sector.[113]

Whilst the Howard Governments' ANTS paper and the Review of Business Taxation report both cited tax simplification as a major consideration in the formulation of policy and recommendations made, it did not consider the consequences of simplifying the definition of the small business sector itself. Rather, such reviews focussed on the introduction of simplified tax rules, the benefits of which would also be expected to flow through to small business.[114]

Whilst all of the above committees attempted to address the tax issues affecting small business, none of them expend any energy in determining whether the starting point; being 'what is a small business?' This is the case notwithstanding the Beddall Report's clear message that this issue is required to be addressed before considering and reviewing the current tax laws and their application and implications for small business.

This failure to properly understand what is meant by small business and its various sub-sets (ie entrepreneur vis-à-vis micro-business vis-à-vis small-medium size business) may go some way to explaining why some of the new tax provisions, introduced over the years, offering tax concessions specifically to this sector have failed miserably.[115]

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113 Joe Hockey, 'Small Business Council First Meeting' (Media Release 03/254, 26 November 2003). The charter of this body is to:

a) provide ongoing advice to the Government through the Minister on any issue affecting small business;
b) identify issues impacting on the growth and development of small business; and
c) explore possible solutions for issues identified, as well as provide ideas to reduce the compliance burden for small business.

114 Commonwealth, *Tax Reform: Not A New Tax, A New Tax System* (1998) 131-52; Commonwealth, Review of Business Taxation, *A Tax System Redesigned: More Certain, Equitable and Durable* (1999) 16-17, 30-34.

115 Michael Dirkis, Tax Institute of Australia, *Taxation Reform for Small Business* (October 2000)124-25; Peter Hendy, 'Threats to Small and Medium Sized Enterprises from Tax and other Regulations' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 134-35; Arthur Athanasiou, Keith Harvey and Shane Bilardi, 'Get a Grip! CGT' (2002) (36) *Taxation in Australia* 290; Brett Bondfield, 'A year on in the Simplified Tax System: Has the reality matched the rhertoric?' (2002) (37) *Taxation in Australia* 251; Michael Dirkis and Brett Bondfield, 'Much Ado About Nothing: Ralph's Consideration of Small Business' (2004) 19 *Journal of the Australasian Tax Teachers Association*.

This contention is also supported by other commentators who, in relation to regulatory reform, argue that policymakers may be failing to give adequate attention to the particular distinguishing characteristics of SMEs.[116]

The ICAA report stated that there was little (if any) rationale provided in relation to the thresholds or criteria adopted for the various concessions available to small business. More specifically, it noted that:

> The results clearly demonstrated the variety, complexity and inconsistency of the tests used. It emerged that very little policy rationale is ever publicly given for choice of particular criteria and there is no 'magic' involved with the choice of a particular threshold, as many were altered a number of times during the consultation process or passage through parliament.[117]

The lack of attention given to the on-going appraisal of the small business sector has been noted time and again.[118]

When one considers that the annual cost of the various small business concessions for the 2006/07 year to be approximately $1 billion,[119] it would be prudent to ensure that such concessions are being properly targeted. It would not be unreasonable for the taxpaying community to expect this as a minimum.

3.6 Corporations Law

The Corporations Act 2001 contains legislative rules which require proprietary companies to be classified as either large or small. Such classification, which is required to be determined on a yearly basis, will then dictate that company's financial reporting obligations.

For these purposes, a proprietary company is defined as a company which has no more than 50 non-employee shareholders.[120]

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116 Peter Hendy, 'Threats to Small and Medium Sized Enterprises from Tax and other Regulations' in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 17.

117 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 5.

118 Mark Burton, 'The Australian Small Business Tax Concessions - Public Choice, Public Interest, or Public Folly?' (2006) (21) *Australian Tax Forum* 71 100-01.

119 Commonwealth, *Tax Expenditures Statement 2004* (2005). This estimate comprises entrepreneur tax offset ($400m), small business CGT concessions ($414m), and STS regime ($180m).

120 *Corporations Act 2001* (Cth) s9, s45A(1), s113(1).

In turn, a "small proprietary company" is defined as one which satisfies at least two of the following criteria:

(a) the consolidated gross operating revenue for the financial year of the company and the entities it controls (if any) is less than $10 million;
(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than $5 million;
(c) the company and the entities it controls (if any) have fewer than 50 employees at the end of the financial year.[121]

A company that does not satisfy at least two of these tests is classified as "large" for Australian Corporations Law purposes.

A small proprietary company generally has reduced financial reporting requirements. More specifically, it is generally not required to prepare an annual financial report or have its financial accounts audited pursuant to the Corporations Act 2001 (subject to certain exceptions).[122] Nevertheless, there may be commercial reasons as to why a small proprietary company would still prepare a financial report.[123]

Interestingly, for accounting purposes, even if a company is classified as a small proprietary company, there may still be different financial reporting obligations for the company depending on whether it is classified as a 'reporting entity' or 'non reporting entity' pursuant to Australian Accounting Standards.

A reporting entity is required to prepare a general purpose financial report in accordance with Australian Accounting Standards, whereas a non-reporting entity is allowed to produce special purpose financial reports which have a much lower level of disclosure requirements.[124]

For the purposes of Australian Accounting Standards, a 'reporting entity' is defined as:

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121 Ibid s9, s45A(2).

122 Ibid s292(2).

123 Thomson, *2005 xyz Model Financial Accounts* (2005) 905-06.

124 For example, this would include financial information presented in a management accounts format using graphs/diagrams, comparisons of actual to budget, whether key performance indicators have been met, and the like to outline the financial performance/position of the company.

an entity (including an economic entity) **in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**, and includes but is not limited to the following:

(a) a disclosing entity; and
(b) a company which is not a subsidiary of a holding company incorporated in Australia and which is a subsidiary of a foreign company where that foreign company has its securities listed for quotation on a stock market or those securities are traded on a stock market. (**Writer's emphasis**)[125]

What can be gleaned from the foregoing is that:

- The definition of 'reporting entity' accommodates, or provides scope to, the preparer of the financial report to decide who the users are, what their information requirements are, and whether such information can be readily obtained by them. This is quite a subjective test which inevitably requires professional judgement to be exercised on a case by case basis. This conceptual approach adopted in Australia is different to some other overseas jurisdictions where a strict numerical threshold is used;[126]
- The definition of 'small proprietary company'
  - has not been changed or even indexed since it was introduced in 1995[127] (ie in terms of the turnover and assets thresholds applied). This effectively means that some (SME) businesses are now unintentionally caught up with this reporting requirement. That is, such SMEs were small (in 1995) but with inflation have become large and must produce a general purpose financial report and have it audited;
  - does not apply to entities other than companies (eg trusts).

125 Australian Accounting Standards Board, *Statement of Accounting Concepts 1: Definition of Reporting Entity*.

126 Stephanie Kemp, 'Non-Reporting Entities' (2004) August *CA Charter*.

127 The Federal Government relieved the requirement to prepare financial statements for defined small proprietary companies in 1995. Institute of Chartered Accountants in Australia, *Submission to the Taskforce on Reducing the Regulatory Burden on Business* (2005).

Lessons that can be learned from our accounting brethren when attempting to define an SME, for tax purposes, are:

- if the definition is too qualitative focussed, this may leave too much room for subjective interpretation leading to unnecessary confusion and conjecture;
- ultimately, a quantitative definition will need to prevail in some way, even if this is 'dovetailed' with some qualitative measures; and
- ideally, any agreed SME definition should be applied across all taxpayer entities, not just specific taxpayer categories (eg companies).

3.7 Other definitions

For completeness, some other definitions of small business include the following:

- For the purposes of the Privacy Act 1988, this includes those entities with an 'annual turnover' of $3m or less.[128]
- Within banking circles,[129] the Australian Bankers' Association defines a 'small business' as one having:
  - Less than 100 full time (or equivalent) people (for a manufacturing business); or
  - Less than 20 full time (or equivalent) people (for all other cases).

4 Conclusion

The many definitions of 'small business', together with all of the issues and anomalies associated with each definition, has resulted in unnecessary confusion and unrest amongst SMEs and their tax advisors.[130] This has also led to a lack of clarity in terms of the availability of the nature and type of small business concessions at the commencement (start up phase) of business, continuation and growth.

128 *Privacy Act 1988* (Cth) s6DA.

129 Australian Bankers' Association, *Code of Business Banking* (2003).

130 Elizabeth Kazi, 'Small Business Gets $150m Tax Windfall', *Australian Financial Review* (Sydney), 14 November 2006, 3.

The generally accepted view seems to be that one clear and uniform definition should be adopted for tax purposes.[131]

However, the difficulties associated with determining what is a 'small business' or 'SME' for tax purposes demands, in the writer's view, that a quantitative approach, rather than a qualitative approach, be adopted when developing tax policy in relation to this sector. Accordingly, such definition should be heavily influenced by a quantitative measure (in addition to qualitative measures used, if any). It would appear that some commentators are in favour of this proposition, providing any quantitative proxy provides a means of identifying SME businesses that will also meet the qualitative criteria that is set.[132] However, it also needs to be acknowledged that this approach does not necessarily have universal support.[133]

Whilst this approach may assist to resolve some of the problems,[134] the issue is that because the qualitative features of an SME are ignored altogether, some businesses which operate in this sector may be harshly dealt with due to a 'cut-off' mechanism effectively being applied solely based on a set of objective numerical criteria. In the writer's view, this conflict is inevitable and unavoidable.

The benefit of this approach, however, is that it does enable one to draw a clear distinction, at a policy level, between concessions targeted at SMEs vis-à-vis concessions targeted at specific groups of taxpayers for other reasons or based on industry incentives.[135] Accordingly, it should be possible to formulate tax policy for SMEs once a definition is agreed, as well as providing other tax concessions for specific purposes which

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131 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 24-28; Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001).

132 Scott Holmes and Brian Gibson, *Definition of Small Business: Final Report* (2001) 17-18.

133 Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 3-4.

134 Current small business definitions have multiple inconsistent criteria, inconsistent definitions of each criterion and differing thresholds to receive concessions. Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business* (2006) 24.

135 For example, it may be that certain concessions are targeted at the agricultural sector and that some SMEs who operate in this sector would also benefit. However, they would receive the concession because they fall within the industry sector, not because they are defined as an SME taxpayer.

are unrelated to definitional issues around "small business".[136] Ideally, in the longer term, one would like to see agreed upon definitions not only around the term SME, but also its various sub-sets (eg micro-business, entrepreneur, etc)[137] and tax policy set accordingly.

There are too many and varied definitions of the term SME and small business. This has contributed to policy makers failing to give due care and attention to the particular distinguishing characteristics of this critical sector of the Australian economy. Consequently, the introduction and maintenance of small business concessions are formulated and implemented without regard to a properly considered definition of the SME sector.

It has been said that the

> mystery of government is not how it works, but how to make it stop[138]

It is hoped that the increasing publication of literature in this area will cause the successive Australian governments to stop, take stock of, and re-evaluate future tax policies impacting the SME and small business sector. Certainly, the Federal Government's current efforts in introducing legislation to standardise the eligibility criteria for small business tax concessions is a (small) step in the right direction. What is clear, is that a change in approach is well overdue.

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136 For example, the exclusion of lap top computers from the FBT regime has enabled taxpayers to more readily access computer technology without any adverse tax consequences arising.

137 It is generally accepted that not all small businesses are entrepreneurial. Storey, *Understanding the Small Business Sector* (1994) .

138 Gary Banks, 'The Good, the Bad and the Ugly: Economic Perspectives on Regulation in Australia' (Speech delivered at the Conference of Economists, Business Symposium, Canberra, 2 October 2003).

Appendix 1 – Summary of Commonwealth Revenue in relation to the Micro-Business and SME sectors in the 2004 – 2005 years

Micro-Businesses	**2004-05**		**2003-04**	
	Liabilities $m	***Collections $m***	***Liabilities $m***	***Collections $m***
Income tax	725	394	868	417
GST	568	438	484	355
Excise	263	260	283	228
Superannuation revenue	1	1	4	3
Superannuation guarantee	150	112	218	153
Other	4	3	1	0.3
Total	**1,711**	**1,208**	**1,858**	**1,156**

Source: ATO Updated Compliance Program 2005-06 (at page 26) and ATO Compliance Program 2004-05 (at page 13).

Small to Medium Enterprises	**2004-05**		**2003-04**	
	Liabilities $m	***Collections $m***	***Liabilities $m***	***Collections $m***
Income tax	716	403	539	293
GST	375	280	320	245
Excise	17	12	35	5
Superannuation revenue	4	4	8	6
Superannuation guarantee	75	50	-	-
Other	1	1	1	1
Total	**1,188**	**750**	**903**	**550**

Source: ATO Updated Compliance Program 2005-06 (at page 40) and ATO Compliance Program 2004-05 (at page 19).

Note: Comparisons could not be made with the most recently published Compliance Program 2006-07 as such information is now presented by way of diagrams and charts.

Notwithstanding this, the release by the Commissioner of Taxation of its annual report of the ATO has 'thrown up' some interesting financial results. In relation to tax collections, it was notable that the total 'tax take' excluding penalties for SMEs amounted to around $1.5b whilst the total tax collections from large businesses approximated $1.7b. Interestingly, the total tax take from micro-businesses also amounted to around $1.7b.

Based on these figures, the total combined tax collected from the SME/micro-business sector is $3.2b, well in excess of taxes collected from large business.

The closeness in the numbers may be the result of the ATO focussing on the 'higher end' of the SME sector (ie. businesses with an annual turnover of between $50m-$100m). Whilst this may be the case, anecdotal evidence and experiences with ATO auditors in the SME sector suggests that there is very little room for negotiation in the settlement process and one wonders whether the closeness in the results has more to do with a higher number of (dollar value) settlements being reached with the large business segment vis-à-vis SMEs and smaller businesses.

Whilst there are a greater number of taxpayers in the SME/micro-business sector, one expects that the issues and the dollars involved are greater in the large business segment. However, it is not possible to discern from the annual report statistics on settlements reached with taxpayers so we may never know.

The annual report indicates that nearly 2,500 cases were settled, but it's not clear who is benefiting most from such settlements. Accordingly, there needs to be greater transparency around the settlement process, and the Commissioner of Taxation be made accountable as to the nature and type of taxpayers he is giving settlements to and the quantum involved.

One statistic that was available is that some 73% of taxpayers and 87% of businesses agreed that the ATO is doing a good job. That may be cold comfort to SMEs who do not have the time or resources to properly defend their position.

Global SME tax policy conundrum

Mark Pizzacalla*

Abstract

There is a real mystery surrounding why so much time seems to be spent by governments around the world on providing small businesses with tax concessions, without seemingly fully understanding, or properly explaining, to their constituents how such tax initiatives fit within their wider tax policy framework.

This article examines Australia's small to medium sized enterprises (SME) tax policy vis–à–vis those of other developed countries, and concludes that Australia has never really had a formal, well defined, articulated tax policy on how it deals with small businesses vis–à–vis small to medium sized businesses and larger businesses.

In Australia, this lack of policy direction has resulted in tax initiatives in the SME sector being introduced in an ad hoc and reactive fashion, and has contributed to policy makers failing to properly identify and target relevant tax concessions in this sector.

Interestingly, it is concluded that Australia is not alone and that other governments around the world have also struggled to come to grips with setting appropriate tax policies in relation to SMEs with political expediency and bandaid solutions being the only two real constants in the quest for SME tax policy direction.

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1. Introduction

There is a real mystery surrounding why so much time seems to be spent by governments around the world on providing small businesses with tax concessions, without seemingly having a full appreciation of how such tax initiatives fit within their wider tax policy framework. The subsequently abandoned introduction by the UK government in 2002 of the zero tax rate band for incorporated businesses is a case directly on point.[1]

Some part of this policy conundrum can be explained away by the difficulties associated with defining what a "small business" is vis-à-vis "small to medium sized enterprises" (SMEs) and larger businesses[2]. Indeed, this is a global issue and has lead to some anomalous results in certain countries.[3] What is clear, however, is that given the importance of the small business/SME sector to the Australian economy,[4] as well as the global economy, it is unacceptable for Australia not to have a formal, well articulated, tax policy in relation to this crucial sector.

It is submitted that there is a lack of tax policy direction in relation to privately held SMEs in Australia, notwithstanding that successive governments have held themselves out to be champions of SME businesses (which may sometimes be viewed, cynically, as being more an exercise in winning electoral favour).[5] It is further submitted that in Australia, this lack of policy direction has resulted in tax initiatives in the SME sector being introduced in an ad hoc and reactive fashion, and has contributed to policy makers failing to properly identify and target relevant tax concessions in this sector. Consequently, SMEs around the world have consistently criticized the tax regulatory environment that they operate in.[6]

Interestingly, however, Australia is not alone in what appears to be a worldwide epidemic as other governments around the world have equally "struggled" to come

1 Judith Freedman, "Why taxing the micro-business is not simple – a cautionary tale from the 'old world'" (2006) 2(1) *JATTA*. HM Treasury, *Small companies, the self employed and the tax system – a discussion paper*, (2004) 4.17.

2 Mark Pizzacalla, "Australia's SME tax identity crisis" (2007) 22(1) *Australian Tax Forum* 19. OECD, *Taxation and Small Businesses*, (1994).

3 For example, in the 1960's, the Small Business Administration (SBA) in the United States used individually determined thresholds for employment or sales for each of the standard industrial classifications. This resulted in the classification of American Motors, which at the time was one of the 200 largest US corporations, being defined as a "small" firm for SBA procurement assistance programmes. Refer Addison W. Parris, "The Small Business Administration" (1968).

4 Senate Economics Reference Committee Parliament of Australia, A *Question of Balance: The Tax Treatment of Small Business*, (1995) 1-5; Ralph Lattimore, et al., *Design Principles for Small Business Programs and Regulations*, Productivity Commission (1998) xv-xvii, 1-3; Peter Hendy, "Threats to Small and Medium Sized Enterprises from Tax and other Regulations" (in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 17).

5 Taxation Institute of Australia (Editorial), "Small Change" (1996) 31(4) *Taxation in Australia* 174, 174-176; Commonwealth, "More Time for Business" (Statement by the Prime Minister John Howard MP, 1997).

6 OECD, *Businesses' Views on Red Tape*, (2001) 9.

to grips with formulating appropriate SME tax policies with political expediency and bandaid solutions being the only real two constants in the quest for SME tax policy direction.[7]

If Australia is to properly nurture and recognize the contribution made to the economy by the SME sector, then its strategy for this sector needs to be formally documented and reflected in the Government's tax policy platform. Successive Australian governments have fallen into the trap of providing generic "feel good" statements about the small business/SME sector, however, unfortunately such good policy intentions have not always translated into workable tangible outcomes.[8]

It is submitted that irrespective of whether or not one supports the case for providing the small business sector with any tax concessions at all,[9] to the extent that such concessions are considered, it should only be in the context of a wider tax policy framework with appropriate supporting policy rationale.[10]

Further, such SME tax policy should be set only once the government of the day has reviewed Australia's small business policies of the past, what has and hasn't worked, and what other countries are doing and factors that have persuaded them to adopt various strategies in relation to the small business/SME sector.[11] Some commentators have questioned whether the Australian federal government has properly considered the

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7 Editorial, (2000) 29 *Australian Tax Review* 131.

8 Michael Dirkis and Brett Bondfield, "The RBT ANTS Bite: Small Business the First Casualty" (2004) 19 *Australian Tax Reform.* 107. Paul Kenny, "Australia's Simplified Tax System for Small Business: Is it any simpler?" (2002) 26 *Tax Notes International* 1405. John McLaren, "The Tax Offset for entrepreneurs: A critical review of the 25 percent tax offset for small business" (2006) 20 *Journal of the Australasian Tax Teachers Association*.

9 Richard Krever, "Taming Complexity in Australia Income Tax" (2003) 22 *Sydney Law Review.* Donald Bruce and Tami Gurley-Clavez, "Federal Tax Policy and Small Business." (2006). OECD, *Taxation and Small Businesses*, (1994) 11-12. Douglas Holtz-Eakin, "Public Policy Towards Entrepreneurship" (2000) 15 *Small Business Economics* 283-291. Claire Crawford and Judith Freedman, "Small Business Taxation – A Special study in selected issues undertaken for the Mirrlees Review – Draft Paper" (2007) 9-14. David Storey, "Understanding the Small Business Sector" (1994) 253-257.

10 Mark Burton, "The Australian Small Business Tax Concessions – Public Choice, Public Interest, or Public Folly?" (2006) 21 *Australian Tax Forum* 71 , 73-74.

11 Ernst & Young, *Helping Britain Thrive*, (2007) This approach was recommended by Ernst & Young as a way of examining the competitiveness of the UK tax regime, in an international context, in determining whether it is an attractive location for inward investment. It concluded that any tax policy designed to support international competitiveness needed to take into account the four leading indicators of the welcoming nature of a tax system, being:

- the tax rate;
- the administrative burden of operating within the system;
- the flexibility of the system; and
- the amount of certainty available.

tax reform options available to it having regard to all of the international evidence.[12] It is submitted that this is an equally valid concern in an SME context.

The purpose of this article is to examine and evaluate the development of Australia's small business/SME tax policy vis-à-vis those of other comparably taxed jurisdictions including the United States of America (US), and the United Kingdom (UK). This analysis will principally focus on Australia's Commonwealth government policy rather than State based issues, as well as overviewing the SME tax policies of the US and the UK.[13]

2. SME Tax Policy Considerations

Given the importance of SMEs to the global economy,[14] most governments around the world have now developed specific policies in relation to the treatment of SMEs, backed up with dedicated resources and funding to ensure the appropriate implementation of such policies.[15] When one looks to Europe until the mid 1990s, EU governments were yet to formulate a coherent policy towards the SME sector.[16] Nonetheless, the vital role played by the SME sector in the European economy has since been reflected in its SME policy, with particular emphasis on the creation of a favourable competitive business environment.[17]

Accordingly, the business environment that SMEs operate in is partly determined by the broad policy approach adopted by governments, as well as the introduction and

12 Geoffrey Kingston, "High Corporate tax checks productivity", *Australian Financial Review*, 19 February 2007, 63.

13 NSW Treasury, *NSW Long-Term Fiscal Pressures Report 2006/07*, (2006/07) 17. Interestingly, this report notes that Australia has a high degree of vertical fiscal imbalance with 82 per cent of all taxation revenues being collected by the Australian Government. However, this is not to say that State based taxes do not have a significant impact on SMEs (e.g stamp duty, payroll tax, land tax).

14 Senate Economics Reference Committee Parliament of Australia, A *Question of Balance: The Tax Treatment of Small Business*, (1995) 1-5; Ralph Lattimore, et al., *Design Principles for Small Business Programs and Regulations*, Productivity Commission (1998) xv-xvii, 1-3; Report of the President's Advisory Panel on Federal Tax Reform, *Simple, Fair & Pro Growth: Proposals to Fix America's Tax System,* (2005) 127-129; Bank of England, *Quarterly Report on Small Business Statistics,* January 1997 cited in Francis Greene, David Kirby, Bahadur Najak, "A Study of Small Businesses in the Northern Region of England: Developing a Taxonomy of Small Firm Growth and Development"; Judith Freeman, "Small Business Taxation: Policy issues and the UK" in Neil Warren (ed), "Taxing Small Business Developing Good Tax Policies"(2003) 20, 13-43.

15 Indeed, some countries have gone as far as to introduce SME Acts including the USA, Japan and Germany, whilst the UK and France have been reluctant to introduce Small Business Acts as such.

16 David Storey, "Understanding the Small Business Sector" (1994) 253-254.

17 Alan Mulhern, "The SME sector in Europe: a broad perspective" (1995) Journal of Small Business Management.

implementation of specific policies and initiatives.[18] Overall, policies to promote the SME sector include the provision of tax relief, direct subsidies and indirect subsidies (eg Government funding programs).

An overview of official international literature indicates that governments around the world have been focusing on the creation and growth of new and small businesses.[19] Whilst government interest in the promotion of such enterprises has various motivations,[20] the OECD considers this strategy to be:

> one of the most promising ways of increasing job creation and boosting the economy, without distorting market forces[21]

In this context, taxation, and in particular high tax rates, has been recognised as being an impediment to firm creation and expansion as well as reducing firm's liquidity (by cutting into retained earnings).[22] However, it is not the purpose of this article to examine the merits, or otherwise, of using tax policy to promote the small business/SME sector. In any event, current literature in this area would seem to indicate that there are mixed views in relation this issue predominantly resulting from a lack of sufficient empirical evidence.[23]

Notwithstanding this, on the basis that government is prepared to provide favourable tax policies to small businesses/SMEs, it is important to understand from the outset, that any small business/SME tax policy may affect one particular sub-set of this sector relative to another, such as:

- sole traders;
- start ups;
- micro businesses;
- entrepreneurs; and
- growth businesses.[24]

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18 APEC Small and Medium Enterprises Working Group, *Profile of SME and SME Issues in APEC 1990 – 2000*, (2002) 20.

19 OECD, *Fostering Entrepreneurship*, (1998).

20 OECD, *Fostering Entrepreneurship*, (1998) 34. Such motivations include combating unemployment and poverty, raising competition in the market, generation of new economic opportunities, and helping to meet the challenges of rapid growth in a globalising economy.

21 OECD, *Fostering Entrepreneurship*, (1998) Foreword.

22 Robert Carroll, et al., "Personal Income taxes and the growth of small firms." cited in Donald Bruce and Tami Gurley-Clavez, "Federal Tax Policy and Small Business" (2006) 5-8.

23 Douglas Holtz-Eakin, "Should small businesses be tax-favored?" (1995) 48(3) *National Tax Journal* 387-388. Claire Crawford and Judith Freedman, "Small Business Taxation – A Special study in selected issues undertaken for the Mirrlees Review – Draft Paper" (2007) 9-14.

24 David Storey, "Should we abandon the support to start-up businesses?" (Working Paper No. 11, Warwick Business School, University of Warwick, 1992). In this paper, the author argues that policies intended to increase the formation rate of new firms are unlikely to be as cost effective with public funds as policies to enable growing businesses to grow faster.

It has been recognised by the OECD that a variety of macroeconomic, microeconomic, institutional and social factors will affect the SME sector.[25] As a result, the introduction of any new policy must work at different levels and can involve increased complexity. By implication, this means that policy content will need to vary from country to country depending on country specific circumstances.

Accordingly, you may find that the introduction of a particular tax policy may favour "start-ups" vis-à-vis currently existing small businesses. Consequently, this may lead one to question whether this outcome is appropriate having regard to other SME requirements.[26]

In an Asia Pacific context at least, it is now common that all Asia-Pacific Economic Cooperation (APEC)[27] economies have adopted policies and programs designed to support SMEs locally, as well as making them more competitive globally.[28] Around 60 per cent of APEC countries adopt policies which intentionally target and discriminate in favour of SMEs, whilst the remainder adopt a more non-discriminatory approach where they develop policies supporting businesses irrespective of their size. Further, whilst the various APEC countries have taken different approaches and implemented different policies for their SMEs, no two economies have exactly the same "package" of policy responses.

More generally, it has only been in recent times, over the past 20-30 years, that western governments have started to identify the small business/SME sector as being a significant component of its suite of strategies to increase employment and productivity.[29] On a more cynical level, it may be argued that governments must at least look interested given the vote earning potential! Either way, what governments have generally been trying to do is formulate strategies that will lead to new firms being established,[30] assist small firms to survive, and encourage more established small firms to grow. As a result, small business tax relief measures are a feature of most tax systems in developed economies.

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25 OECD, *Fostering Entrepreneurship*, (1998) 36.

26 David Storey, "Should we abandon the support to start-up businesses?" (Working Paper No. 11, Warwick Business School, University of Warwick, 1992).

27 APEC was established in 1989 and comprises 21 member economies including the US, Canada, New Zealand and Australia.

28 APEC Small and Medium Enterprises Working Group, *Profile of SME and SME Issues in APEC 1990-2000*, (2002).

29 Sue Birley and Paul Westhead, "Growth and Performance Contrasts between 'types' of small firms" (1990) 11 *Strategic Management Journal* 535-557.

30 For example, in an Australian context, the Entrepreneurial Offset Tax concession was introduced by the Coalition Government, effective 1 July 2005, to assist and encourage small business entrepreneurs, especially those who set up from home.

Overlayed on top of this is the stark reality that significant growth is the exception rather than the rule amongst small business,[31] with the majority of firms spending the whole of their economic life in the small business sector.[32]

Accordingly, when formulating policy, governments require a deeper understanding of the composition of its SME sector and not just focus on targeting growing businesses as has been reflected, for example, in a number of European Union policy pronouncements, directives and recommendations. This focus has been criticised by the Economic and Social Committee who have stated that:

> we must avoid unrealistic expectations at this stage which are likely only to result in disappointment. There are of course many fast growing firms, which contribute to the growth of employment. But at the same time there are also many microenterprises that offer people working for them a decent standard of living. These firms are not growing however and do not want to grow. And yet these often locally operating firms make up the bulk of the small business sector and play an irreplaceable role in European economies.[33]

On the other hand, rapid growth in small businesses creates other problems that threaten the business' ability to sustain itself over time.[34] Their growth (or lack thereof) is dependant on a number of internal factors (eg owner/manager objectives, management structure, and production capabilities) and external factors (eg product/market structure, location).[35] Such enterprises are also hampered by the usual barriers to entry being fiscal, financial, and institutional.

Accordingly, SME policy needs to cater for a wide variety of business profiles within the one category of taxpayer, bearing in mind that not all businesses that survive grow to be large businesses. It is, therefore, imperative when governments are setting tax policy to have an understanding of the problems and growth patterns of SMEs from start ups/entrepreneurs to the more mature privately held corporate groups.[36] Admittedly, in practice, this may be too high a "bar" to jump. However,

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31 OECD, *Fostering Entrepreneurship*, (1998) 141.

32 Sue Birley and Paul Westhead, "Growth and Performance Contrasts between 'types' of small firms" (1990) 11 *Strategic Management Journal* 535-557.

33 Opinion of ECOSOC on the communication from the Commission on the Council, "Fostering entrepreneurship in Europe: Priorities for the Future" (27 May 1998) cited in Judith Freedman, "Small Business taxation: Policy issues and the UK" in Neil Warren (ed) *Taxing Small Business Developing Good Tax Policies* (2003) 22, 13-43.

34 Charles J Fombrun and Stefan Wally, "Structuring small firms for rapid growth" (1989) 4 *Journal of Business Venturing* 107-122.

35 Lawrence L Steinmetz, "Critical Stages of small business growth: When they occur and how to survive them" (1969) *February Business Horizons*.

36 Lawrence L Steinmetz, "Critical Stages of small business growth: When they occur and how to survive them" (1969) *February Business Horizons*.

if achieved, this would lead to a greater understanding in diagnosing problems,[37] as well as matching solutions to SME business issues.[38]

Whilst there are a plethora of models developed which map out the relevant stages of growth for both businesses generally and smaller businesses specifically,[39] there are sufficient similarities in the issues identified that may make such models useful for setting future tax policy. However, due to the non-homogeneous nature of the small business/SME sector it would be presumptuous to set SME policy solely based on one model. Indeed, some of the research conducted in relation to the small business lifecycle suggests that policy may need to be set for clusters of firms rather than trying to form generalized theories in relation to the entire SME sector.[40]

What is submitted here is that such models are not meant to be the panacea for small business/SME tax policy formulation,[41] but rather may be used as a diagnostic tool to assist in helping to predict what strategies appear suitable having regard to the composition of the SME sector at a particular point in time. It has also been recognised that the "absorptive capacity"of SMEs is an important consideration in policy formulation.[42]

Overall, one must come to accept that designing measures to assist the small business/SME sector is extremely difficult as this process traverses many complex areas of tax policy.[43] This requires a real skill when trying to balance conflicting policy aims, as well as competing vested interests.

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37 For example, in a US context, the removal of the double taxation of dividends (classical system) may assist profitable mature SME businesses, but would be of little use to start-ups/new businesses. By way of comparison, in Australia, recent changes to the Dividend Imputation regime have meant that private companies can fully frank dividends in their first taxable year notwithstanding that no company tax was actually paid by year end providing certain conditions are met (refer s 205-70(5) of Income Tax Assessment Act 1997). This concession facilitates the payment of franked distributions by recognising that companies do not (physically) pay tax in their first taxable year of operation and, therefore, have no franking credits available in that year.

38 Neil Churchill and Virginia Lewis, "The five stages of growth in small business" (1983) (May-June) *Harvard Business Review* 43-54.

39 Mel Scott and Richard Bruce, "Five Stages of Growth in Small Business" (1987) 20 *Long Range Planning* 46, 45-52.

40 Sue Birley and Paul Westhead, "Growth and Performance Contrasts between 'types' of small firms" (1990) 11 *Strategic Management Journal* 535-557.

41 The author recognises and acknowledges the limitations in relation to small business growth theories which include, *inter-alia*, insufficient emphasis on the difficulties faced by small owner-managed firms in meeting the competitive requirements of the market place, most studies are based on the manufacturing sector, discuss only one or two aspects of a firm's profile, have an assumed inbuilt correlation between size and performance, and generally limited by incomplete and/or unreliable data.

42 OECD, "Best practice policies for small and medium sized enterprises" (1997) 7 and 58. An SME's absorptive capacity refers to its ability to have sufficient awareness about the availability of advice, that such advice is of real value, and the managerial ability to then act upon the advice.

43 OECD, *Taxation and Small Businesses*, (1994).

3. Australia's Approach

The SME sector is critically important to the Australian economy.[44] Broadly, using the most recent Australian Bureau of Statistics data for the 2000-01 year, the small business sector represented around 97 per cent of all private sector businesses and employed around 3.6 million people.[45] Whilst Australia has been on a journey of significant tax reforms over the past 30 years, this has been punctuated by some false starts, bandaid fixes, and ad hoc reactive solutions. Following is a brief summary of this period as it relates to the small business/SME sector. Further, refer **Table 1** for a summary of Australia's major tax reform processes and SME outcomes.

The Asprey Committee,[46] established in 1972, was the first of its kind in Australia to conduct a full scale public inquiry into the operation of the taxation system which would put the government in a position to have an overall look at tax policy in Australia. Whilst the full report, released in 1975, made a number of wide ranging suggestions, none were forthcoming in relation to the small business/SME sector. With the benefit of hindsight, when one considers the tax climate of the time, this is not surprising. Notwithstanding, many tax issues were canvassed by the Asprey Committee which would impact the SME sector including:

- the number of acceptable tax rate bands and consequences for taxpayers when moving into higher tax brackets;[47]
- differential taxing of property income;[48]
- the taxing of individuals versus family unit basis;[49]
- a broadening of the consumption base and the lowering of income tax rates (otherwise known these days as the GST!).

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44 Senate Economics References Committee, Parliament of Australia, A *Question of Balance: The Tax Treatment of Small Business* (1995) 1-5; Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) xv-xvii, 1-3; Peter Hendy, "Threats to Small and Medium Sized Enterprises from Tax and other Regulations" in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 17.

45 Australian Bureau of Statistics, *Small Business in Australia*, Catalogue No. 1321.0 (2001).

46 Asprey Report, 1975, *Taxation Review Committee,* Full Report [Canberra, Australian Government Publishing Service (AGPS)].

47 Asprey Report, 1975, *Taxation Review Committee,* Full Report [Canberra, Australian Government Publishing Service (AGPS)] paras 14.4 -14.5.

48 Asprey Report, 1975, *Taxation Review Committee,* Full Report [Canberra, Australian Government Publishing Service (AGPS)] paras 14.8-14.14.

49 Asprey Report, 1975, *Taxation Review Committee,* Full Report [Canberra, Australian Government Publishing Service (AGPS)] paras 10.15-10.22.

Whilst the Asprey Report attracted significant attention, it was perhaps the classic "false start" failing to generate political momentum and did not lead to any immediate legislative amendments.[50]

It was not until the mid-1980's when the Hawke Labour government organized a "Tax Summit" in 1985 proposing an overhaul of the income tax and sales tax systems including the release of its paper entitled "Reform of the Australian Tax System" (commonly referred to as the Draft White Paper).[51]

Interestingly, the draft White Paper did not address SMEs as a separate sector of the taxpaying community (although it did address specific issues which are common in the SME sector such as the taxation of trusts).[52] Nor was any specific mention made by the (former) Treasurer, Mr Paul Keating, in his paper which accompanied the 1985 tax reforms.[53]

It was not until 1988 that the first inquiry to ever be undertaken in relation to small business in Australia by a Federal Parliamentary Committee was established. The findings were documented in a report from the House of Representatives Standing Committee on Industry, Science and Technology (the Beddall Report).[54]

The purpose of this Committee was for it to inquire into the problems facing small business. More specifically, on 24 March 1988, the Minister for Science, Customs and Small Business requested the Committee to investigate:

1. the unique problems faced by small businesses as a result of the extensive yet fragmented regulations under which they are governed and ways in which the administration of regulations can be improved;
2. the impact of government policies in such areas as taxation, superannuation, training, marketing, access to information/advice and industrial relations;
3. the ultimate extent of impact of policies on small businesses compared with larger businesses.[55]

Note that it was only the impact that the policies of the day had on small businesses vis-à-vis larger businesses that were investigated, rather than the underlying rationale

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50 In fact, only a few of the Asprey Committee's recommendations were acted upon given the controversial circumstances in which the then Whitlam government was dismissed. This had the effect of diverting national attention away from the tax issues with the newly installed Fraser Coalition government shying away from any major legislative initiatives (including tax) having regard to the continual criticism levelled at its legitimacy to govern.

51 As an aside, it is interesting to note that Australian Treasury in preparing the Draft White Paper relied on criteria similar to those set out in the 1966 Report of the Royal Commission on Taxation (Carter Report), a study commissioned by the Canadian government.

52 Commonwealth, *Reform of the Australian Tax System: Draft White Paper*, (1985) 52-7.

53 Paul Keating, *Reform of the Australian Taxation System: Statement by the Treasurer* (1985).

54 House of Representatives Standing Committee on Industry Science and Technology Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities*, (1990).

55 House of Representatives Standing Committee on Industry Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) viii.

behind such policies (or potential new policies). Notwithstanding that the Committee sought to deal with a wide range of issues facing small businesses of which taxation was only one,[56] during the course of its inquiry, the Beddall Committee revealed that the area of greatest regulatory concern to small business was taxation, particularly:

> The rapid growth in the size and complexity of taxation law, the complex and often apparently uncoordinated administrative systems which support it, and the associated compliance and reporting costs which are particularly onerous for small business.[57]

The Beddall Committee noted that this results in a disproportionate impact on small business due to:

- economies of scale: and
- the inability of many owner operated businesses to bring the costs of taxation compliance to account as a tax deduction against income (ie smaller businesses do not generally have an "in house" accountant and so need to weigh up the opportunity costs of management performing this function vis-à-vis loss of potential earnings (if the time was spent on business) and opportunities lost (for business expansion and development).[58] This point was also acknowledged, some years later, by the Small Business Deregulation Task Force (Bell Task Force).[59]

The Beddall Committee went on to conclude that:

> extensive research is required in order to discover the importance of small business in the economy, the opportunities it provides and the difficulties it faces. Such research depends upon the collection of reliable and comprehensive data about small business.[60]

These words would turn out to be quite prophetic because when tax laws are introduced which do not differentiate between small, medium and large business, the direct effect is that the compliance burden of "coming to grips" with the new provisions will fall disproportionately on the SME/small business sector. This is really the key to "unlocking" SME tax policy. At the time of the Beddall Committee, and into the 1990's, reliance on statistical data in relation to the nature and type of taxpayers was either non-existent or of limited use.[61] Since then, the ATO is now able to "slice and dice" its

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56 House of Representatives Standing Committee on Industry Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) xi.

57 House of Representatives Standing Committee on Industry Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) xxix.

58 House of Representatives Standing Committee on Industry Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) xxix.

59 Small Business Deregulation Task Force Commonwealth of Australia, *Time for Business*, (1996) 28.

60 House of Representatives Standing Committee on Industry Science and Technology, Parliament of Australia, *Small Business in Australia: Challenges, Problems and Opportunities* (1990) xiv.

61 Vince Mitchell, "Managing Risks: The 'Small Business Income' Approach" (1997) 13 *Australian Tax Forum* 55, 65-9. In this article the author identifies various concerns in relation to identifying the composition of the small business sector from an ATO audit compliance perspective.

"client" base like never before which can be accessed and utilised by government and Australian Treasury when setting tax policy. (Whilst the introduction of Regulation Impact Statements has gone some way to ameliorating government decision making process, there is still room for improvement).[62]

Subsequent to the Beddall Committee's review, the tax treatment of small business was then considered by the Senate Economics References Committee (SERC) which found that, five years on, whilst some of the recommendations of the Beddall Committee benefited small business, a number of the tax problems they faced remain essentially unchanged.[63] It would seem that certain of these issues are just as much a concern today as they were then.

The terms of reference provided to the SERC for inquiry and report were as follows:

a) the impact of the timing of the payments of taxation, particularly provisional tax, PAYE tax, tax under the prescribed payments system and fringe benefits tax, company tax and wholesale tax, on the cashflows of small business;

b) changes in the overall burden of tax on small business, in particular the impact of tax changes introduced by and since the 1993 budget, including increases in excise and wholesale sales tax;

c) whether the tax system can be improved to prevent tax falling due prior to the taxable income actually being received by small business;

d) the appropriateness of the quantum, and current form, of the provisional tax uplift factor;

e) the appropriateness of the thresholds for early payment of company tax for small business;

f) the potential for reducing tax compliance costs for small business through the improvement of tax payment arrangements; and

g) such other matters as the committee considers to be reasonably relevant to the above terms of reference on improving the tax treatment of small business.

Once again, the focus of the inquiry was on specific tax issues of concern to the small business sector at that time, as well as the impact of recent budgetary tax changes, rather than identification of what the Government's existing small business/SME tax policy is and whether it is indeed appropriate.

Importantly, however, the SERC did acknowledge that the:

62 Peter Hendy, "Threats to Small and Medium Sized Enterprises from Tax and other Regulations" (Speech delivered at the Small Business Tax Symposium, Developing Good Tax Policies for SMEs, Sydney 22 August 2003) 11-12.

63 Senate Economics Reference Committee Parliament of Australia, A *Question of Balance: The Tax Treatment of Small Business*, (1995) 1-5.

> relative advantage enjoyed by larger businesses in using economies of scale and associated tax deductions to cope with compliance costs and tax imposts should be balanced to some extent by certain concessions to small business.[64]

Accordingly, this report did not comment on the Government's existing small business/SME tax policy (or lack thereof), but rather focused on making recommendations on relevant tax issues to counter the disadvantages faced by small business predominantly in relation to their compliance with tax laws.

Soon after, in 1996, the Small Business Deregulation Task Force (Bell Task Force) was established to, *inter-alia*, review the compliance and paper burden imposed on small businesses, and the options available to reduce such burden.[65]

The Bell Task Force's role was not to explore tax policy, but rather to focus on the paperwork and compliance burden on small business. It found that:

> the taxation system is too complex and expensive in terms of the number of taxes, the complexity and associated uncertainty of the law, the frequency of changes, the difficulty of interpretation and the costs of compliance.[66]

It is submitted that whilst there were three reviews conducted in relation to the small business sector over a six year period, insufficient attention was given to the current status and appropriateness of the government's small business/SME tax policy. Consistent with previous Parliamentary Committees, the focus was on what the current tax issues of the day were rather than taking the opportunity to stand back and review the small business tax environment at a macro level and trying to understand why the issues were there to begin with and how to avoid introducing future tax changes that would similarly have an adverse tax impact for SMEs.

Worse still, the Bell Task Force was asked by the Government to only advise on:

> revenue-neutral ways to halve the paperwork and compliance burden on small business.[67]

This led the Bell Task Force to concede that the:

> need to maintain revenue-neutrality and not consider taxation policy limited the scope and nature of the recommendations.[68]

And that:

> previous efforts to reduce compliance costs have had mixed success and many in the small business community are cynical about this current effort.[69]

The former Howard Government's response to the Bell Task Force's report was to focus on specific tax issues affecting small businesses contained within the FBT,

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64 Senate Economics Reference Committee Parliament of Australia, A *Question of Balance: The Tax Treatment of Small Business*, (1995) 3.

65 Small Business Deregulation Task Force Commonwealth of Australia, *Time for Business*, (1996) vii.

66 Small Business Deregulation Task Force Commonwealth of Australia, *Time for Business*, (1996) 28.

Small Business Deregulation Task Force Commonwealth of Australia, *Time for Business*, (1996) 12.

68 Small Business Deregulation Task Force Commonwealth of Australia, *Time for Business*, (1996) 12.

69 Small Business Deregulation Task Force Commonwealth of Australia, *Time for Business*, (1996) 14.

CGT, depreciation, and PAYG regimes.[70] Whilst it acknowledged that the number one issue identified by small business related to the complexities of dealing with the tax system, its response was to focus on the micro-management of blatantly obvious tax laws which had received adverse media coverage at the time and assumed that by fixing a handful of problems, the government would be seen to be dealing with the problems.[71]

Since 1996, the former Howard Government's approach to small business/SMEs has been to focus on the reduction of compliance costs to this sector.[72] The then newly elected Prime Minister, Mr John Howard, stated that:

> dealing with our complex tax system was the number one compliance issue identified by small business.[73]

Tax proposals introduced since the Bell Task Force have all, to some extent, failed to deliver optimal outcomes for the SME sector including:

- ANTS reform package (which did not properly address the compliance cost impact on small business);[74]
- the Ralph Review[75] (which introduced the Simplified Tax System and small business CGT concessions which mainly assist those selling their business). The introduction of various small business concessions which are complex and difficult to interpret and apply (including the Simplified Tax System and the Small Business CGT concessions);[76]
- more generally, limitations imposed on the Ralph Review driven by the political circumstances surrounding the implementation of a number

70 Commonwealth, "More Time for Business" (Statement by the Prime Minister, the Hon John Howard MP, 1997) iv.

71 An example of this was the introduction of an FBT exemption for taxi travel which was extended to cover travel to and from the place of work at any time of the day. Previously, this exemption only covered taxi travel provided by employers to employees for travel directly to and from home between the hours of 7pm to 7am or for sick employees for travel home or to any other place that is necessary or appropriate for the employee to go as a result of illness or injury (eg to a doctor or relative) (former s 58Z of FBTAA).

72 Notwithstanding this, the reduction of compliance costs was not a key focus of the ANTS package, although it was one of the aims of the Ralph Review.

73 Commonwealth, "More Time for Business" (Statement by the Prime Minister, the Hon John Howard MP, 1997) iv.

74 Michael Dirkis and Brett Bondfield, "The RBT ANTS Bite: Small Business the First Casualty" (2004) 19 *Australian Tax Reform* 110.

75 Michael Dirkis, Tax Institute of Australia, *Taxation Reform for Small Business* (October 2000) 132-41. Australian Tax Review, "Editorial" (2000) 29 AT Rev 131.

76 Michael Dirkis and Brett Bondfield, "The RBT ANTS Bite: Small Business the First Casualty" (2004) 19 *Australian Tax Reform* 107.

of the recommendations, as well as being restricted by the requirement that any recommendations made be revenue neutral;[77]

- introduction of integrity measures such as the personal services income rules (specifically targeted at small contractors) and non-commercial loss provisions (specifically targeted at small start up ventures) which added to the already increasing compliance burden on the small business sector;
- introduction of the Tax Consolidation regime (effective 1 July 2002) which meant that if small wholly owned groups did not consolidate, they would not be able to benefit from the inter-corporate dividend rebate provisions, loss transfers between group companies, and CGT roll-overs for asset transfers between group companies;
- introduction of the new capital allowances regime (forcing small business to re-educate themselves on a traditional area of tax law);
- introduction of the additional 175 per cent R & D tax deduction, which does not seem to benefit Australian SMEs whose R & D expenditure is usually quite lumpy in recognition of the need to either exploit market opportunities as they arise or reduce their R & D spend when cash is "tight"[78]; and
- introduction of the new 25 per cent entrepreneur's tax offset (which arguably adds to taxpayer's compliance costs, as well as a further layer of complexity in the law which may negate any potential tax benefits).[79]

It was then not until November 2003 that a new national small business consultative body was established to advise on the broad range of issues affecting the small business sector.[80] More recently, the former federal Small Business Minister, Ms Fran Bailey,

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77 Business Council of Australia, *Tax Nation: Business Taxes and the Federal-State Divide*, (April 2007) 18.

78 Jason Clout, "R & D Swings reflect trading reality", *Australian Financial Review*, 5 June 2007, 49. Sophie Morris, "Erratic R & D spending reduces tax concessions", *Australian Financial Review*, 28 May 2007, 10.

79 John McLaren, "The Tax Offset for entrepreneurs: A critical review of the 25 percent tax offset for small business" (2006) 20 *Journal of the Australasian Tax Teachers Association* . The Australian government's approach to the introduction of the 25 per cent entrepreneurs tax offset would seem to indicate that unless you improve the tax framework within which SMEs operate, you will not be able to influence taxpayer attitudes and behavioural patterns towards enterprise in general.

80 Joe Hockey, "Small Business Council First Meeting" (Media Release 03/254, 26 November 2003). The charter of this body is to:

a) provide ongoing advice to the Government through the Minister on any issue affecting small business;

b) identify issues impacting on the growth and development of small business; and

c) explore possible solutions for issues identified, as well as provide ideas to reduce the compliance burden for small business.

flagged her intention to revamp the role of this body and expected to reflect the demand from small business for support in areas such as innovation, marketing and home based businesses.[81]

The former Howard Government's ANTS paper and the Review of Business Taxation report both cited tax simplification as a major consideration in the formulation of policy and recommendations made. Whilst this was not a major step forward for small businesses/SMEs specifically (in that the government of the day was acknowledging that simplification was key to achieving appropriate policy outcomes, as a general proposition, rather than being specifically directed at the SME sector), the goal of achieving simplification in tax policy formulation is considered critical by some commentators in the small business/SME sector.[82] Accordingly the above reviews focussed on the introduction of simplified tax rules, the benefits of which would also, by definition, be expected to flow through to small business.[83]

Whilst all of the above committees attempted to address the tax issues affecting small business, none of them dealt with properly analyzing tax policy in relation to this sector. This failure, together with the government's inability to properly understand what is meant by small business and its specific requirements and needs, may go some way to explaining why some of the new tax provisions, introduced over the years, offering tax concessions specifically to this sector, have failed miserably.[84]

This was also evidenced recently in the former Howard Government's 2007 May Budget which included provisions to ease the compliance burden for small businesses by:

- increasing the GST registration threshold from $50,000 to $75,000 (annual turnover); and
- ensuring that business owners will no longer have to provide a tax invoice to claim a GST input tax credit on purchases of $75 or less (an increase from the previous threshold of $50).[85]

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81 Mark Fenton-Jones, "Council seeks new expertise", *Australian Financial Review*, 27 March 2007, 45.

82 Mark Pizzacalla, "Australia's SME tax identity crisis" (2007) 22(1) *Australian Tax Forum* 19.

83 Commonwealth, *Tax Reform: Not A New Tax, A New Tax System* (1998) 131-52; Commonwealth, Review of Business Taxation, A *Tax System Redesigned: More Certain, Equitable and Durable* (1999) 16-17, 30-34.

84 Michael Dirkis, Tax Institute of Australia, *Taxation Reform for Small Business* (October 2000)124-25; Peter Hendy, "Threats to Small and Medium Sized Enterprises from Tax and other Regulations" in Neil Warren (ed), *Taxing Small Business Developing Good Tax Policies* (2003) 134-35; Arthur Athanasiou, Keith Harvey and Shane Bilardi, "Get a Grip! CGT" (2002) (36) *Taxation in Australia* 290; Brett Bondfield, "A year on in the Simplified Tax System: Has the reality matched the rhertoric?" (2002) (37) *Taxation in Australia* 251; Michael Dirkis and Brett Bondfield, "Much Ado About Nothing: Ralph's Consideration of Small Business" (2004) 19 *Journal of the Australasian Tax Teachers Association*.

85 Commonwealth, Federal Budget 2007.

Such changes, however, are hardly "ground breaking" and many commentators have queried the Government's seriousness in the way it has approached tax policy in the SME sector.[86]

This contention is supported by a study commissioned by the Institute of Chartered Accountants which concluded that there was little (if any) rationale provided in relation to the thresholds or criteria adopted for the various concessions available to small business.[87] More specifically, it noted that:

> The results clearly demonstrated the variety, complexity and inconsistency of the tests used. It emerged that very little policy rationale is ever publicly given for choice of particular criteria and there is no "magic" involved with the choice of a particular threshold, as many were altered a number of times during the consultation process or passage through parliament. [88]

The lack of attention given to the on-going appraisal of the small business sector has been noted time and again,[89] which is extraordinary when one considers that the annual cost of the various small business concessions for the 2006/2007 year to be approximately $1 billion.[90]

Having regard to the foregoing, it becomes readily apparent that Australia does not have a clear tax policy on how small business/SMEs should be taxed. Whilst it has been generally accepted in Australia's business community that the former Howard Government's A New Tax System (ANTS) package (released in 1997), combined with the Ralph Review of Business Taxation (released in 1999), provided a platform for genuine tax reforms to occur, neither of these focussed specifically on the SME sector.[91]

In Australia, this has arisen for a number of reasons including:

- There has never been a clear definition of what is an SME so that appropriate tax policies can be properly developed and targeted to meet the requirements of this sector.[92]

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86 Damien Lynch, "GST changes lighten the load", *Australian Financial Review*, 15 March 2007, 47.

87 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business*, (2006) 10-17.

88 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business*, (2006) 5.

89 Mark Burton, "The Australian Small Business Tax Concessions – Public Choice, Public Interest, or Public Folly?" (2006) 21 *Australian Tax Forum* 71, 73-74.

90 Commonwealth, *Tax Expenditures Statement 2004* (2005). This estimate comprises entrepreneur tax offset ($400m), small business CGT concessions ($414m), and STS regime ($180m).

91 Business Council of Australia, *Keeping a Permanent Watch on Australia's Tax System*, (March 2006); Ralph Lattimore, Alan Madge, Barbara Martin and James Mills, Productivity Commission, *Design Principles for Small Business Programs and Regulations* (1998) 2.

92 Institute of Chartered Accountants in Australia, *Research and Recommendations on Definition of Small Business*, (2006) 10-17.

- Lack of appropriate statistical data to assist the government of the day with policy decision making in relation to SMEs.[93]
- The manner in which SMEs are taxed quite often depends on their legal form, not size. This has always added an extra layer of complexity when formulating tax policy for this sector.[94]
- A failure on the part of major tax reform committees to properly consider SME tax issues as a subset of the overall tax reform process.[95]

Indeed, this lack of attention to SME tax policy is a global issue and has lead to some anomalous results in certain countries.[96] Whether the above reasons are valid is open to debate. What is confusing, however, is that it is not that the Australian government does not appear to be aware of how important it is to have an appropriate tax climate for small business and the advantageous flow on effects that this can have for the rest of the economy. By way of example, in the former Howard government's Review of Business Taxation report, in relation to venture capital for SMEs, it was stated that:

> The proposals in respect of venture capital are aimed at encouraging investment in small, innovative businesses. This is an area which could be a major contributor to higher economic growth and employment. Experience in other countries, most notably the US but also in the UK, has been that creating the right investment climate can lead to major growth of innovative small businesses. These small businesses are the large businesses of tomorrow. An economic climate that is conducive to the spawning of new businesses is more likely to generate an economy of greater vitality and creativity which is the mechanism for delivering higher living standards to the Australian community.[97]

Unfortunately, the focus of the report in relation to small businesses quickly reverted to identifying simplified tax systems for small business. This is not to say that it is not

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93 Vince Mitchell, "Managing Risks: The 'Small Business Income' Approach" (1997) 13 *Australian Tax Forum* 55, 65-9. In this article the author identifies various concerns in relation to identifying the composition of the small business sector from an ATO audit compliance perspective.

94 Commonwealth, *Tax Reform: Not A New Tax, A New Tax System*, (1998) 109-110. Whilst not directed specifically at SMEs, the Howard Government has recognised the problems and issues associated with the different tax treatment being afforded to the various entities and at the individual investor (eg shareholder) level, and has adopted the view that the same investment should not attract a different tax treatment simply because of the type of structure adopted (eg trust versus company). Notwithstanding, it is important to note that the Howard Government's attempt to introduce a standard "entity" taxation regime was subsequently withdrawn.

95 Michael Dirkis and Brett Bondfield, "The RBT ANTS Bite: Small Business the First Casualty" (2004) 19 *Australian Tax Reform* 107.

96 For example, in the 1960's, the Small Business Administration (SBA) in the United States used individually determined thresholds for employment or sales for each of the standard industrial classifications. This resulted in the classification of American Motors, which at the time was one of the 200 largest US corporations being defined as a "small" firm for SBA procurement assistance programmes. Refer Addison W. Parris, "The Small Business Administration" (1968).

97 Commonwealth, *Tax Reform: Not A New Tax, A New Tax System*, (1998) 131-52; Commonwealth, Review of Business Taxation, A *Tax System Redesigned: More Certain, Equitable and Durable* (1999) 33.

a worthwhile thing to do, however, one would expect that such changes would have been considered as part of an overall SME tax policy.

It would appear that the Labor party, whilst in opposition, was also focusing on tax compliance and administrative issues in relation to SMEs with the announcement of a plan to offer SMEs a choice of three methods when completing their GST business activity statements.[98] In the past, the Democrats have also taken a similar approach.[99] On a more macro level, the former Howard government has also been criticized for not providing business with an internationally competitive environment.[100] Its procrastination in not legislating measures that have already been announced leading to uncertainty for taxpayers who are simply trying to get on with business.[101]

The former Howard Government recently introduced new legislation to standardize the eligibility criteria for small business tax concessions effective 1 July 2007.[102] In essence, this means that there will be one small business test to access all small business tax concessions.

Currently, there are separate eligibility tests for access to small business concessions in relation to a range of taxes including GST, the Simplified Tax System, CGT, FBT and PAYG. However, as a result of the announcement, all businesses with an annual turnover of less than AUD $2m will be able to access these concessions (subject to transitional measures).

The former Howard Government indicated that around 2 million businesses will be able to qualify which represents 96 per cent of all Australian businesses, and that this translates to tax cuts for small businesses of AUD $150M. Certainly, the streamlining of the term "small business" into a single definition should result in reduced compliance costs, however, it remains to be seen whether the savings will be this great.

Having regard to the definitional issues associated with SMEs, this attempt to define "small business" for tax purposes should be commended. Whilst the new provision has received some criticism, it at least provides a framework for small business to work with.[103] (By way of example the new criteria ignores the fact that some small businesses have a high turnover but a small profit margin.[104] Funnily enough, the federal government has acknowledged this point in relation to the setting of new (higher) collective bargaining limits for small businesses which will rise

98 Fleur Anderson, "Three ways to do your BAS", *Australian Financial Review*, 20 April 2007, 10. David Crowe and Laura Tingle, "Labor blasts PM over red tape", *Australian Financial Review*, 3 October 2007, 1.

99 *CCH Tax Week*, "Australian Democrat's tax policy" (2001) 41, para 654.

100 Robert Carling, "Tax Reform: we have barely scratched the surface", *Australian Financial Review*, 16 April 2007.

101 Fleur Anderson, "Tax reforms lost in consultation", *Australian Financial Review*, 24 April 2007, 3.

102 Tax Law Amendment (Small Business) Act 2007 (Clth).

103 Helen Hodgson, "Small business simplification – yet again?" (2007) 2 (2) *The TAX Specialist* 132.

104 Damien Lynch, "Getting a handle on small business", *Australian Financial Review*, 20 February 2007, 17.

substantially[105].) Business taxation reform continues to be the number one priority for most SME interest groups.[106] In Canada, certain SME interest groups also believe that the competitiveness of the SME sector largely rests within the tax system.[107]

It is submitted that a more focused approach on different segments of the SME sector with appropriately targeted key tax initiatives and incentives should deliver greater outcomes vis-à-vis previous attempts (such as the failed Simplified Tax System regime).

Australia has embarked on a number of significant tax reforms in the past 30 years. Notwithstanding this, small business/SMEs have only come into some form of consideration since around 1990,[108] and concerns voiced by various business groups in relation to the growing burden, complexity and compliance costs experienced when operating a business in Australia has not diminished over this period. The disproportionate tax burden faced by small business has also been formally recognised by big business.[109]

Notwithstanding the significant reforms which have taken place in Australia's tax landscape during this period, it is submitted that the net benefits accruing to small business/SMEs are not as significant as they could have been. The introduction of the various tax concessions targeted at small business have generally been complex, costly to access, and difficult to administer, thus offending most (if not all) of the essential criteria when assessing a tax system; being equity, efficiency, and simplicity.[110]

This has generally lead various tax commentators to the conclusion that even though Australia has conducted a number of comprehensive tax reviews, the adoption of recommendations for major reform has been piecemeal and delayed, and generally responsive and politically acceptable rather than visionary or fully committed.[111] Compare this with the swiftness shown by the Australian Government in changing the implementation date for scrip takeovers in response to big business lobby groups.[112]

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105 Fred Benchley, "Big bargaining break for small business", *Australian Financial Review*, 27 March 2007, 5.

106 Small Business Coalition, 2007/08 SBC Policy Agenda, retrieved from *www.smallbusiness.org.au.*

107 David Fletcher, "Positioning Canadian SMEs for world leadership" accessed on line at www.managementmag.com on 11 October 2007.

108 Such reforms have included the introduction of CGT, FBT, Dividend Imputation, GST, and reductions in corporate and personal tax rates. It should be noted, however, that it is almost a decade since Australia's last significant tax reform process was initiated (ie being the Ralph Review which commenced in 1998).

109 Business Council of Australia, *Tax Nation: Business Taxes and the Federal-State Divide*, (April 2007), ii.

110 Commonwealth, *Reform of the Australian Tax System: Draft White Paper*, (1985.) 14-17; Business Council of Australia, *Keeping a Permanent Watch on Australia's Tax System*, (March 2006) 7.

111 Margaret McKerchar, Laura R Ingraham and Stewart Karlinsky, "Tax Complexity and Small Business: A Comparison of the Perceptions of Tax Agents in the United States and Australia" (2005) *Journal of Australian Taxation*.

112 Patrick Durkin, "Takeover tax spares done deals", *Australian Financial Review*, 17 October 2007, 3; Neil Shoebridge, "PBL queries answered, time to split", *Australian Financial Review*, 17 October 2007, 56.

More recently, big business called on the former Howard Government to conduct a comprehensive review of the effectiveness of Australia's business tax system.[113] It is submitted that any such review should also consider the small business/SME sector to avoid being another lost opportunity in Australia's tax reform process.

4. USA's Approach

Small businesses in the US are just as important to the economy and social fabric as they are in Australia. In the US, small businesses:

- employ 58 per cent of the non farm workforce and 39 per cent of the high tech workforce;
- generate 43 per cent of sales and 51 per cent of private GDP; and
- nearly all (99 per cent) of the 22.4m US non-farm companies (in 2001) were small businesses.[114]

There are more than 22 million small businesses (ie businesses with less than US $1m in receipts) which account for more than 95 per cent of all businesses vis-à-vis about 150,000 large businesses (ie businesses that have more than $10m in receipts.)[115]

US policy in relation to small business can be officially traced back to the introduction of the Small Business Act 1953 and the establishment of the Small Business Administration (SBA) which is an independent agency that operates under the authority of this Act. In reality, however, the events which lead to this point began to unravel years earlier through various predecessor agencies largely resulting from the pressures of the Great Depression and World War II.[116] Nonetheless, since that time, it has been the declared policy of the US Government to:

> aid, counsel, assist and protect insofar as is possible, the interests of small-business concerns[117]

The charter also stipulates that the SBA would ensure small business a "fair proportion" of government contracts and sales of surplus property.

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113 Business Council of Australia, *Tax Nation: Business Taxes and the Federal-State Divide*, (April 2007), iii; Peter Hendy, "Everyone wins with tax cuts", *Australian Financial Review* 17 October 2007, 71.

114 S Karlinsky and G Payne, *"A Comprehensive Analysis of how US and Australian Income Tax Law Define and Encourage Small Business"*, (2005, unpublished manuscript) cited in Margaret McKercher, Laura Ingraham and Stewart Karlinsky, "Tax Complexity and Small Business: A comparison of the Perceptions of Tax Agents in the United States and Australia" (2005) *Journal of Taxation*.

115 Report of the President's Advisory Panel on Federal Tax Reform, *Simple, Fair & Pro Growth: Proposals to Fix America's Tax System*, (2005) 127–129.

116 www.sba.gov/aboutsba/history/index.html accessed online on 22 September 2007.

117 The preamble (s 2) of the US 1953 Small Business Act.

The SBA also makes loans directly to businesses and acts as a guarantor on bank loans. As an objective measure, it is interesting to note that the SBA's current business loan portfolio is around 219,000 loans which are worth more than US$45bn which makes it the largest single financial backer of US businesses in the country.[118]

In 1976, an Office of Advocacy was established in the SBA under the original Act. The role of the Chief Counsel for Advocacy, who reports directly to the President, is to represent small business interests. This arrangement would seem to be unique to the US. Arguably, SMEs in Australia do not have such a body that truly represents all their interests in a similar way.[119] However, this is not to say that the SBA has not had its fair share of critics,[120] and has been widely criticised for its lack of focus and co-ordination.[121]

Further, in recognition of the importance of small business, the federal Regulatory Flexibility Act was introduced in 1980 which requires federal agencies to analyse the impact of proposed regulations of small firms. Subsequently, in 1996, the US Congress passed the Small Business Regulatory Enforcement Fairness Act which enables an affected small entity to take an agency to court if, *inter-alia*, it failed to properly take into account the impact of regulatory costs by firm size.

Having regard to the foregoing, this would seem to suggest that there is merit in the proposition that since the late 1960's, US small business policies have focused on serving to act as a redistributive instrument.[122]

Notwithstanding the above policy approach in the US, some commentators have noted that the US government's recent tax reforms have not favoured the small business sector whilst, at the same time, paying "lip service" to simplifying the country's complex tax laws.[123] Further, it has been noted that small business policy

118 www.sba.gov/aboutsba/history/index.html accessed online on 22 September 2007.

119 Dr Michael Schaper, "Small business not always heard", *Business Review Weekly*, 15-21 March 2007, 73.

120 Jonathan Bean, "Who needs the SBA? An historical perspective on the Small Business Administration" (2001).

121 Yuko Aoyama, "Local economic revitalization or national industrial growth? A comparative review of small business policy in Japan and the US" (1995) *Journal of Urban and Regional Development Studies* 6.

122 Yuko Aoyama, "Policy Interventions for Industrial Network Formation: Contrasting Historical Underpinnings of the Small Business Policy in Japan and the United States" 12(3) *Small Business Economics* 217-231.

123 S Karlinsky and G Payne, "A Comprehensive Analysis of how US and Australian Income Tax Law Define and Encourage Small Business", (2005, unpublished manuscript) cited in Margaret McKerchar, Laura R Ingraham, and Stewart Karlinsky, "Tax Complexity and Small Business: A Comparison of the Perceptions of Tax Agents in the United States and Australia", *Journal of Australian Taxation*, 2005. It was noted that there was little funding provided to support small business in the US Government's 2004 budget and of the US$674bn in tax cuts, only $18bn was targetted at small business.

in the US has been strongly influenced by power relations of interest group politics, which has skewed the SME policy agenda over the years.[124]

In a recent study which compared and contrasted the perceptions of practitioners on small business tax in the US vis-à-vis Australia, it was noted that cutting tax rates or simply rewriting existing legislation does not lead to a simplification in the law.[125] It has been contended that in respect of small businesses specifically, providing special rules for a targeted group may reduce the compliance burden.[126] Both the US and Australia have adopted this (carve out) approach to varying degrees. However, whether this leads to increased simplicity in the application of tax laws for SMEs ultimately depends on whether the group was effectively targeted and/or the application of, and the number of exceptions to, the rules.[127]

It was, therefore, refreshing that in the most recent major report written on US tax reform, Report of the President's Advisory Panel on Federal Tax Reform[128], that it provided for a somewhat radical Simplified Income Tax (SIT) Plan in relation to small business and SMEs whereby:

- Medium sized businesses (ie businesses with more than US$1m but less than US$10m in annual receipts) would be taxed on a cash basis at a flat rate of 33 per cent. They would be subject to a simplified depreciation system for business assets, and simplified inventory methods;
- Small businesses (non-corporate businesses with receipts less than US $1m) would report income based on a cash receipts less cash business expenses basis, as well as being entitled to immediately expensing all business expenditures (except for land and buildings) thus removing all fixed asset and depreciation related issues; and

124 Yuko Aoyama, "Local economic revitalization or national industrial growth? A comparative review of small business policy in Japan and the US" (1995) *Journal of Urban and Regional Development Studies* 1-23.

125 Margaret McKerchar, Laura R Ingraham and Stewart Karlinsky, "Tax Complexity and Small Business: A Comparison of the Perceptions of Tax Agents in the United States and Australia" (2005) *Journal of Australian Taxation*.

126 Margaret McKerchar, Laura R Ingraham and Stewart Karlinsky, "Tax Complexity and Small Business: A Comparison of the Perceptions of Tax Agents in the United States and Australia" (2005) *Journal of Australian Taxation*. This article provides a concise comparison of the tax carve-outs provided for small business under US tax law vis-à-vis Australian tax law.

127 One only needs to look at Australia's small business CGT concessions, contained in Div 152 of the Income Tax Assessment Act 1997, to appreciate the complexity and enormity of the task facing practitioners as they try to apply the market net asset value test or the associate provisions. Similarly, consider the complexities surrounding the "associated company" definition in s 416 of the Income and Corporation Taxes Act 1988 in the UK.

128 This report into the US tax system is the most important and wide ranging plan to reform the US federal tax system since Blueprints for Basic Tax Reform (1977).

- For the purposes of classifying a business as small, medium or large, gross receipts would be used based on the business' prior three year average.[129]

Whilst this discussion was only minor relative to the principal purpose of the tax review (which was to debate whether income or consumption should be the appropriate tax base in the USA), it nonetheless publicly acknowledged that (i) the tax system for businesses is overly complex and inefficient, (ii) small business owners bear disproportionately higher compliance costs, and (iii) there is a lack of uniformity in the tax treatment of small business entities.[130] All these issues contribute to the difficulties facing legislators when formulating small business tax policy.

In addressing the President's Advisory Panel, on behalf of the President of the United States, Secretary Snow acknowledged that the US government was committed to:

> major tax reform, to real tax reform, to something more than just moving boxes around, to finding what the opportunities are here to make the tax code fairer, simpler, and more growth orientated.[131]

And that:

> It's pretty clear we're on the wrong path … There are a few things more complex than trying to figure out how to improve tax policy.[132]

They say that it is only "when you confront a problem you begin to solve it".[133] In this context, at least, it would seem that The President's Advisory Panel recognised not just the complexity involved with the US tax code but were also concerned about its impact as a potential tax barrier to small business/entrepreneurial entry and survival.

This is important when one considers that in the US virtually all small businesses pay their taxes through the individual income tax system (either as a sole proprietor or because their structure takes the form of a pass through entity such as a partnership or sub-chapter S Corporation.)[134]

It is certainly encouraging that when large scale federal tax reform of this nature is being contemplated, that policy makers and researchers are also taking into account small business/SME considerations. If, as some of the tax literature is finding, that tax

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129 Report of the President's Advisory Panel on Federal Tax Reform, *Simple, Fair & Pro Growth: Proposals to Fix America's Tax System* (2005) 127–128. Donald Bruce and Tami Gurley-Clavez, "Federal Tax Policy and Small Business" (2006) 5-8, 17-19.

130 Report of the President's Advisory Panel on Federal Tax Reform, *Simple, Fair & Pro Growth: Proposals to Fix America's Tax System*, (2005) 126-127.

131 Report of the President's Advisory Panel on Federal Tax Reform, *First Meeting of Minutes*, 16 February 2005.

132 Report of the President's Advisory Panel on Federal Tax Reform, *First Meeting of Minutes*, 16 February 2005.

133 Rudi Giuliani, retrieved from http://www.abc.net.au/tv/enoughrope/transcripts/s927551.htm.

134 Donald Bruce and Tami Gurley-Clavez, "Federal Tax Policy and Small Business" (2006) 5-85.

policies have salient implications for entrepreneurial activities,[135] then given the role that this sector plays in the economy, it would be prudent to always ensure that any change in tax policy does not have any material adverse impact on the small business/ SME sector.

5. UK's Approach

By way of historical background, up until the 1960's and 1970's, UK government policy focused on large scale plants and organizations, with new opportunities arising for producers to exploit economies of scale.[136] Small business was considered to be a distant cousin to its big business counterpart and the small firm sector was in a state of long term decline.

The UK government's interest in small business can be dated back to 1969 and the establishment of the Committee of Inquiry on Small Firms (the Bolton Committee) which then subsequently released its report in 1971.[137] Over 35 years has now passed since the publication of this report which identified a number of areas of interest as being crucial to the small business sector in Britain.

Importantly, the Bolton Committee recognised that the interests of smaller enterprise were being neglected by government. This meant that the formulation of policy proceeded without any real understanding of the impact of likely effects on them resulting from government actions. The findings of this Committee effectively provided for an on-going agenda of small firm policy intervention in the UK.

At that time, the Bolton Committee defined a small business by way of industry classification (eg manufacturing, retailing), together with a statistical definition (eg turnover, or number of employees). In modern times, a small business in the UK is defined differently for company law vis-a-vis tax law purposes. This approach is not dissimilar to that of Australia. The most common definition can be found in the Companies Act which is derived from EU law.[138] Under this definition a company is small (or medium) if it satisfies at least two of the following conditions:

- its turnover is not more than £5.6 million (medium £22.8 million);
- its balance sheet total is not more that £2.8 million (medium £11.4 million);

135 Donald Bruce and Tami Gurley-Clavez, "Federal Tax Policy and Small Business." (2006) 19. William M. Gentry and R Glenn Hubbard, "Tax Policy and Entrepreneurial Entry" (2000) 90 *American Economic Review* 283, 283-287. Robert Carroll, et al., "Personal Income taxes and the growth of small firms", cited in Donald Bruce and Tami Gurley-Clavez, "Federal Tax Policy & Small Business" (2006).

136 HM Treasury, *Small companies, the self employed and the tax system – a discussion paper*, (2004); HM Treasury, "Enterprise Britain: a modern approach to meeting the enterprise challenge" (2002) 12.

137 J.E Bolton, (Chairman), "Report of the Committee of Inquiry on Small Firms" (1971) *Cmnd 4811 HMSO.*

138 Section 247 of the 1985 Companies Act implementing EU Directive 78/660/EEC cited in Judith Freedman, "Small Business taxation: Policy issues and the UK" in Neil Warren (ed), "Taxing Small Business Developing Good Tax Policies" (2003) 21, 13-43.

- it has not more than 50 employees (medium 250 employees).[139]

On the other hand, for UK tax purposes, the concept of a "close company" is used to approximate an owner/manager run enterprise. A "close company" is defined as "one which is under the control of five or fewer participators, or of participators who are directors".[140]

During the 1970's there was a resurgence in the small business sector which can be partly attributed to the changing economic and structural environment in the UK.[141] Notwithstanding this, overall growth remained moderate by international standards.[142] In relation to SMEs, what is particularly interesting during this period is that, subsequently, the publication of the Meade Report in the late 1970s, considered to be a landmark in the study of tax design, provides little with regard to the taxation of SME's.[143] In fact, no mention is made of the term "small" or "SME" in the 551 page document! (In some ways, this is no different to the lack of attention given to the SME sector by the Asprey Report[144] in Australia.)

Subsequently, the UK government took the view that high rates of tax were detrimental to enterprise leading them to make a series of tax rate reductions (particularly since the late 1970's). In fact, the UK government viewed a more beneficial tax regime as being an important factor in stimulating enterprise.[145]

During the 1980s, there was a major shift in government policy more towards the small firm and self employed sector.[146] The UK government took a more proactive approach in promoting an "enterprise culture" which coincided with the rise of self-

139 Section 247 of The Companies Act 1985 implementing EU Directive 2003/38/EC of 13 May 2003 amending Directive 78/660/EEC (refer Statutory Instrument 2004 No.16). These thresholds for small and medium sized companies are also relevant for the purposes of expenditure of small and medium sized enterprises under ss 47 and 48 of the Capital Allowances Act 2001 (c.2).

140 Section 414 Income and Corporation Taxes Act 1988.

141 HM Treasury, *Enterprise Britain: a modern approach to meeting the enterprise challenge*' (2002) 13.

142 HM Treasury, *Enterprise Britain: a modern approach to meeting the enterprise challenge*' (2002) 21.

143 J.E.Meade (Committee Chair), "The Structure and Reform of Direct Taxation", The Institute for Fiscal Studies (1978). Professor Jones Meade chaired this Committee whose brief was to make a study of the UK tax system as a whole. The Institute for Fiscal Studies asked the Committee to produce a statement of the objectives of taxation, including an assessment of any conflicts between different objectives; to comment on the present system in the light of these objectives; and to make recommendations for reform.

144 Asprey Report, 1975, *Taxation Review Committee,* Full Report [Canberra, Australian Government Publishing Service (AGPS)].

145 Martin T Robson and Colin Wren, "Marginal and Average Tax Rates and the Incentive for Self-Employment" (1999) 65(4) *Southern Economic Journal* 757, 757-773.

146 Marc Cowling and Peter Mitchell, "The Evolution of UK Self-Employment: A Study of Government Policy and the Role of the Macroeconomy" (1997) The Manchester School Vol LXV No.4 427-442, 427. HM Treasury, *Enterprise Britain: a modern approach to meeting the enterprise challenge*' (2002) 14.

employment.[147] There was also concern that company incorporations in the UK were significantly lower than in the USA.[148] Notwithstanding the issues confronting small businesses during this period, and the government's good intentions, "knee jerk" policy making and piecemeal changes (usually in response to lobby groups) characterized the small firm environment in the UK during this era.[149]

More recently, in 2002, the former Blair government was concerned that business start up rates in the US are almost twice as high as those in Britain,[150] and so recognised the need to have in place measures to support entrepreneurs. During this period, the government took a three prong approach to small business ensuring that:

(i) there were business conditions which promoted fair competition and creation of incentives by minimising taxation and regulatory concerns;

(ii) there were more positive social attitudes exhibited towards small business; and

(iii) there was sufficient government support to enable small firms to access finance, information, professional advice and training.[151]

This approach was adopted notwithstanding the Government's recognition that not all small businesses have the ambition to grow, however what was important was the role that such businesses can have in diffusing new ideas/technologies which larger firms can then replicate and leverage from.[152]

Similar to other developed economies, as discussed herein, small business plays a vital role in the UK economy. A Bank of England report in 1997 identified around 3.7m businesses in the UK, over 99 per cent of them employ less than 100 people, and are responsible for 53.6 per cent of total employment and 44.3 per cent of the total turnover of the economy.[153] Recent statistics indicate that around 62 per cent of businesses are sole proprietors, 15 per cent are partnerships and 23 per cent are companies.[154]

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147 David Storey, "Should we abandon the support to start-up businesses?" (Working Paper No. 11, Warwick Business School, University of Warwick, 1992), 1. The UK government's approach included, *inter-alia* the creation of the Enterprise Allowance Scheme, free and subsidised advice for "start ups", and the establishment of training programs.

148 David Storey, "Should we abandon the support to start-up businesses?" (Working Paper No. 11, Warwick Business School, University of Warwick, 1992), 9.

149 David Storey, "Understanding the Small Business Sector" (1994) 4 and 257.

150 HM Treasury, *Enterprise Britain: a modern approach to meeting the enterprise challenge*' (2002) Foreword.

151 UK Department of Employment, *Small Firms in Britain*, (1989).

152 HM Treasury, "Small companies, the self employed and the tax system – discussion paper" (2004), 6.

153 Bank of England, *Quarterly Report on Small Business Statistics*, January 1997 cited in Francis Greene, David Kirby, Bahadur Najak, "A Study of Small Businesses in the Northern Region of England: Developing a Taxonomy of Small Firm Growth and Development".

154 Judith Freedman, "Small Business Taxation: Policy issues and the UK" in Neil Warren (ed), "Taxing Small Business Developing Good Tax Policies" (2003) 20, 13-43.

By 2005, the number of private sector enterprises grew to 4.3m of which 99 per cent of small firms have less than 50 employees and 96 per cent of such firms had fewer than 10 employees.[155] SMEs accounted for more than half of the employment (58.7 per cent) and turnover (51.1 per cent) in the UK.[156] The number of small businesses is showing the fastest rate of growth since 1995.[157]

However, whilst public policy in the UK has attempted to support the small business/SME sector, it has had similar difficulties (as other developed economies) when setting its strategy given the:

- diversity of small business;
- incomplete nature of the data on small businesses; and
- variety of ways in which a small business may be defined.[158]

Similar to Australia, as in most developed economies, each legal form is taxed under a different regime which adds to the complexity when formulating SME tax policy.[159] In a UK context, worked examples have shown that the tax differential between an individual in paid employment vis-à-vis operating through alternative structures can range from 42 per cent to 22 per cent. Interestingly, it has been argued that the reason behind this significant gap has little to do with the extra risks and lower benefits of self-employment and more to do with political expediency.[160]

Since its election in 1997, the former Blair Labour Government focused heavily on small business taxation as well as targeting reduced regulatory and compliance burdens for small businesses, and encouraging investment and entrepreneurship.[161] This is consistent with the approach adopted by Australia[162] and other developed economies during this period, including the US.[163]

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155 Small Business Service SME Statistics cited in Claire Crawford and Judith Freedman, "Small Business Taxation – A Special Study in selected issues undertaken for the Mirrlees Review – Draft Paper" (2007).

156 Department for Business, Enterprise and Regulatory Reform National Statistics Press Release, 31 August 2006.

157 HM Treasury, *Small companies, the self employed and the tax system – a discussion paper*, (2004) HM Treasury, "Small companies, the self employed and the tax system – a discussion paper" (2004), 15.

158 Francis Greene, David Kirby and Bahadur Najak, "A Study of Small Businesses in the Northern Region of England: Developing a Taxonomy of Small Firm Growth and Development".

159 Judith Freedman and John Ward, "Taxation of Small and Medium-Sized Enterprises" (2000) 40 EUR.TAX. 158.

160 Anne Redston, "Small Business in the Eye of the Storm" (2004) *British Tax Review* 566-581, 572.

161 HM Treasury, "Small Companies, the role of the self employed and the tax system – a discussion paper" (2004) 3.

162 David Crowe and Laura Tingle, "Labor blasts PM over red tape", *Australian Financial Review*, 3 October 2007, 1. Craig Emerson, "Real reforms for small business", *Australian Financial Review*, 3 October 2007, 63.

163 Such as the introduction in the US of the 1980 Regulatory Flexibility Act and the 1996 Small Business Regulatory Enforcement Fairness Act.

The Better Regulation Task Force was set up in September 1997 and guidelines[164] were established in relation to the introduction of new regulations which requires government departments to "think small first"[165] when deciding whether and how to introduce new legislation that affects business (with similar guidelines being adopted across the EU.)[166] Accordingly, since 1998, UK government departments and agencies have been required to prepare Regulatory Impact Statements (RIS)[167] when introducing new (or amending) legislation that imposes (or reduces) significantly the costs and benefits to businesses, consumers, or the environment.

The UK government's approach to removing unnecessary regulations and making existing and new regulations better can be traced back to several of the Cabinet Office's papers.[168] However, recent research has identified that perhaps such assessments are not being conducted with sufficient rigor by government departments,[169] and that there is no evidence that progress is being made in reducing or even containing the burden of tax regulations affecting small businesses.[170] Notwithstanding, one shouldn't

164 Subsequent to the re-election of the Blair government in 1997, its focus shifted from deregulation to better regulation. The Better Regulation Task Force was then set up in September 1997 to advise the UK government on the quality of its regulations taking particular account of the needs of small businesses and ordinary people. The BRTF established 5 main principles to be used for judging and improving the quality of regulation. Cited in John Hasseldine and Ann Hansford, "The Compliance Burden of VAT: Further Evidence from the UK" (2002) 17, *Australian Tax Forum* 369 – 388, 372.

165 The "Think Small First" principle is based on the premise that legislation should be drafted for small businesses, with add-ons for those with more complex requirements, rather than being designed for larger organisations and then requiring the smaller firms to make decisions about opting out.

166 Francis Chittenden, Tim Ambler and Monika Shamutkova, *Government Policy for SMEs: Do Regulators "Think Small First"?*, (Working Paper No. 451, Manchester Business School) 2-6.

167 This replaced the UK's Compliance Cost Assessments system, the main purpose of which was to broaden the scope of the regulatory appraisals, with special emphasis being placed on the impact on SMEs.

168 These include Cabinet Office's "Modernising Government" White Paper (1997), "Principles of Good Regulation" paper (1997), and "Professional Policy Making for the 21st Century" paper as cited in Francis Chittenden, Tim Ambler and Monika Shamutkova, "Government Policy for SMEs : Do Regulators "Think Small First"?" Working Paper No. 451, Manchester Business School, 3.

169 Francis Chittenden, Tim Ambler and Monika Shamutkova, *Government Policy for SMEs: Do Regulators "Think Small First"?*, (Working Paper No. 451, Manchester Business School) 2. Better Regulation Task Force, "Helping Small Firms Cope with Regulation-Exemptions and Other Approaches" (2000) London: Cabinet Office Publications and Publicity Team, 4.

170 Francis Chittenden, Saleema Kauser and Panikkos Poutziouris, "Tax Regulation and Small Business in the USA, UK, Australia and New Zealand" (2003) 21 *International Small Business Journal* 93-115, 93.

be too despondent about such things as there will always be difficulties associated with trying to apply a small business "litmus test" to the introduction of new laws.[171]

In this regard, it is interesting to compare the UK's tax regime with that of Australia. In a recent report into Australia's business tax system, it was noted that:

> the business tax system is incredibly complex. Business in Australia must either bear or collect a total of 56 corporate taxes – more than double the number of taxes identified in the United Kingdom, an economy almost three times the size of the Australian economy.[172]

It is generally acknowledged by Australian business commentators that this is not just an issue for large businesses given that:

> The problems of growing complexity, overlap and the compliance burden highlighted in the report are compounded for small and medium-sized businesses with fewer resources to deal with these issues.[173]

At a more macro level, the former Blair government's enterprise policy had two key objectives, being:

- to build an enterprise friendly environment; and
- to correct for specific market failures that create obstacles to successful enterprise.[174]

A key part of the Blair government's small business policy platform was the establishment of the Small Business Service (SBS) in April 2000 as an agency of the Department for Trade and Industry (DTI). The SBS's goal was to ensure that the UK is the best place in the world to start and grow a business.[175] The US has also recognised the process of globalisation as it affects SMEs and the need for them to compete successfully in the international marketplace and, consequently, has also begun to alter its SME policy objectives in response to this.[176]

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171 C Evans and M Walpole, *Compliance Cost Control: A Review of Tax Impact Statements in the OECD*, Australian Tax Research Foundation (1999) as cited in John Hasseldine and Ann Hansford, "The Compliance Burden of VAT: Further Evidence from the UK" (2002) 17 *Australian Tax Forum* 369-388, 372.

172 Business Council of Australia, "*Tax Nation: Business Taxes and the Federal-State Divide*", April 2007. This compares with 22 taxes in the UK.

173 Kate Lahey, "The Tax Attack: Governments hit companies", *The Age*, 10 April 2007.

174 HM Treasury, *Enterprise Britain: a modern approach to meeting the enterprise challenge*' (2002) 25.

175 Small Business Service, Foreword to SBS (2003).

176 Yuko Aoyama, "Local economic revitalization or national industrial growth? A comparative review of small business policy in Japan and the US" (1995) *Journal of Urban and Regional Development Studies* 8. The US has deliberately avoided sector specific policies towards small business in its policy reformulation process.

It should be noted that the SBS has been renamed as the "Enterprise Directorate"[177] and is now no longer an executive agency.[178] As part of this process, the government put together a strategic framework for a government-wide approach to helping small business based around seven themes identified as key drivers for economic growth, improved productivity, and enterprise for all.[179] More recently, in 2002, the former Blair government was concerned that business start up rates in the US are almost twice as high as those in Britain,[180] and so recognised the need to have in place measures to support entrepreneurs.

Consequently, more recent UK Budgets have focused on providing various forms of relief to SMEs so as to both encourage entrepreneurship as well as remove any tax barriers to SME growth.[181] The main reason behind this approach was because the UK was falling behind France, Germany and the US in productivity terms. Accordingly, the principal aim behind the majority of the tax measures implemented in 2001 was to improve levels of entrepreneurship, investment, and innovation by UK based businesses.[182]

More specifically, one such initiative has been the introduction of the limited liability partnership (LLP) in the UK in 2001. Some commentators have suggested that the new LLP system will provide a more suitable vehicle for SMEs (compared to the ordinary limited company). However, others have indicated that this new legal form was not designed specifically for SMEs, nor in response to small business concerns, but rather the LLP came about as a result of political pressure exerted by large professional firms to obtain limited liability in relation to their activities and from their unwillingness to incorporate.[183] Also in 2001, a new tax credit for research and development (R & D) was, for the first time, giving accelerated relief to small companies (although the R & D regime was criticized, in its original form,

177 Mr Stephen Timms, Minister of State for Competitiveness, announced the renaming of the SBS as the "Enterprise Directorate" effective 17 July 2007, the new name reflecting the Department for Business, Enterprise and Regulatory Reform (BERR) emphasis on enterprise and growth. The Enterprise Directorate will continue to be the expert policy unit on small business issues throughout government. Refer www.dti.gov.uk/bbf/small-business accessed online on 7 October 2007.

178 As a result of a government review, it was decided that the SBS should cease operating as an Executive Agency and become a smaller, sharply focussed enterprise policy unit within the DTI's Enterprise and Business Group effective 1 April 2007.

179 Department for Trade and Industry, A *government action plan for small business*, (2004).

180 HM Treasury, *Enterprise Britain: a modern approach to meeting the enterprise challenge*' (2002) Foreword; Department of Trade and Industry, "Small business and government: The way forward", (2002).

181 Inland Revenue, "Boosting investment and growth for small businesses" (2001) accessed on line at www.inlandrevenue.co.uk.

182 Ernst & Young, *Helping Britain Thrive* (2007) 7. Tax measures considered included intellectual property relief, a substantial shareholding exemption, and expansion of the research and development tax credit.

183 Judith Freedman, "Limited Liability Partnerships in the United Kingdom – Do They Have a Role for Small Firms?" (2001) *The Journal of Corporation Law* 897, 898.

for its complexity.)[184] Around this time, the UK government also "flirted" with the possibility of aligning the measure of taxable profits more closely with the commercial results shown in company accounts for SMEs, however no consensus position was ultimately reached.[185]

Unfortunately, not all of the UK government's efforts have borne fruit. Perhaps the best example of UK SME policy gone wrong is the introduction of the zero tax rate band for incorporated businesses in 2002 but which was subsequently repealed in 2006.[186] This initiative introduced a zero per cent tax rate on the first £10,000 of corporate profits and created much excitement resulting in a significant increase in incorporations. However, in the attempt to stimulate growth through tax policy, because of its poor targeting, together with complex "anti-avoidance" provisions, meant that any potential tax benefits quickly dissipated.[187] The zero per cent tax rate was meant to incentivise businesses, but thousands of businesses incorporated simply as a means of benefiting from the tax advantage and nothing else.[188] Even small tradesmen, taxi-drivers, milkmen and other one-man-bands were interested in registering as a company![189]

Perhaps, this is evidence that there is some truth in the proposition that it is doubtful that an economy benefits overall by competing aggressively on the basis of tax rates. Rather, a government's efforts should be in the areas of simplicity and convenience.[190]

In the Blair government's 2004 Budget, it started to express its concerns over the number of self-employed people moving to incorporate their businesses for tax reasons rather than as a step to growth.[191] But the real question is "what did the UK government think would happen?" Rather than blame taxpayers for taking advantage of a legitimate concession on offer and one which was described by the Paymaster General as a "gift horse",[192] the government should really have gone back and reviewed the original basis for the policy as well as the manner of its execution (or what appears to be a lack thereof.)[193] It was only logical that by introducing a zero rate corporate tax for small businesses that an increase in incorporations would follow, but it was widely assumed that the government thought that this was a cost worth paying to

184 Ernst & Young, *Helping Britain Thrive* (2007) 11.

185 HM Treasury, "Reform of Corporation Tax: A consultation document" (2002) 2.

186 Judith Freedman, "Why taxing the micro-business is not simple – a cautionary tale from the 'old world'" (2006) 2(1) *JATTA*. HM Treasury, *Small companies, the self employed and the tax system – a discussion paper*, (2004); HM Treasury, "Small Companies, the role of the self employed and the tax system – a discussion paper" (2004) 4.17.

187 Francesca Lagerberg, "Small Business Measures" (2005) *Taxation.*

188 Anne Redston, "Small Business in the Eye of the Storm" (2004) *British Tax Review* 566-581.

189 Peter Rayney, "Get back ... to where you once belonged" (2007) *Taxation* accessed on line through www.taxation.co.uk.

190 Fleur Anderson, "Tax treaties miss boat, says Labor", *Australian Financial Review*, 28 September 2007, 11.

191 HM Treasury, *Small companies, the self employed and the tax system – a discussion paper*, (2004) 15.

192 Hansard (16 May 2002) column 115.

193 Mike Truman, "Am I bovvered?" (2005) *Taxation*.

encourage start ups.[194] To compensate for the abolition of the zero corporation tax, the rate of first year allowances for expenditure by small businesses on qualifying plant and machinery was increased from 40 per cent to 50 per cent[195] (however one must question how this would assist those small business who do not incur capital expenditure).

Consequently, small business tax policy has caused some angst amongst SMEs in the UK and, as a result, their relationship with Government has been strained.[196] If anything, it has made it even more difficult for taxpayers to choose an appropriate business vehicle out of which to conduct their business activities.[197] More recently, the decision by the new Chancellor of the Exchequer, Alistair Darling, in the 2007 Pre-Budget Report to end capital gains tax relief has been criticized for discouraging small companies and venture capital funds from investing in the longer term.[198]

Notwithstanding the foregoing, the UK has continued to persist with having two key corporation tax rates: the small companies rate (of 20 per cent on profits of up to £300,000) and the main rate (of 30 per cent on profits above £1.5m) with marginal relief available should profits fall between the two bands.[199]

In many respects, Australia has followed the UK's lead in relation to major tax reforms introduced including, by way of example, the Controlled Foreign Companies regime, Good and Services Tax, and, more recently, the Tax Consolidation regime. Similarly, it would seem that there are definite lessons that can be gleaned from the UK SME experience which should be heeded in any Australian SME tax policy re-think.

6. Conclusion

It would seem that irrespective of whether SMEs are operating in the luxury of a developed economy or in more difficult circumstances presented by some of the more extreme transition economies, the establishment and growth of such enterprises

194 Kevin Nicholson, "Enterprising Budget?" (2006) *Taxation* accessed on line at www.taxation.co.uk on 18 August 2007.

195 Paula Tallon, "Give us a (tax) break" (2006) *Taxation* accessed on line at www.taxation.co.uk on 18 August 2007.

196 Judith Freedman, "Why taxing the micro-business is not simple – a cautionary tale from the 'old world'" (2006) 2(1) *JATTA*. HM Treasury, *Small companies, the self employed and the tax system – a discussion paper* (2004) 4.17. Sarah Butler, "Tax change a 'kick in the teeth' for small firms", *The Times*, 22 March 2007, accessed online on 10 April 2007.

197 Peter Rayney, "Get back ... to where you once belonged" (2007) *Taxation* accessed on line through www.taxation.co.uk.

198 Gabriel Rozenberg, "Darling holds dialogue with business over tax reform", *The Times*, 22 October 2007 accessed on line at www.business.timesonline.co.uk on 22 October 2007.

199 Rates effective for the 2007/08 tax year, accessed online at www.businesslink.gov.uk on 7 October 2007.

is usually hampered by the same barriers, being fiscal barriers, financial barriers, and institutional barriers.[200]

Of these, in Australia at least, tax remains one of the most obvious constraints to small business investment.[201] Arguably, the most critical observation arising from the compliance cost studies is that small firms bear a disproportionate burden of costs compared to larger firms.[202]

Given the benefits that small business has to offer the economy in terms of employment, innovation, and competition to larger firms, governments around the world should continually focus on and monitor the barriers which impede and inhibit the small business/SME sector.[203] The greater such barriers, particularly in relation to taxation, may affect small business attitudes to voluntary compliance,[204] something which successive Australian governments have always been wary of.[205]

Indeed, it has been recognized by revenue authorities across the leading developed countries (including the US and UK), in relation to international tax reform, that any changes must be aimed at making local business more competitive internationally and that this affects domestic private groups as much as it does larger global corporations.[206] In this regard, the White Paper "Removing Tax Barriers to International Growth" (White Paper) made the following observation:

> The fundamental issue remains – how to sustain Australia's growth path by attracting and retaining high growth dynamic companies. That growth is needed to create employment and economic development.
>
> These issues are not just "big end of town" issues. They affect the formation of new and emerging businesses in Australia, and whether these remain in Australia or whether their headquarters and commercial centres shift overseas to other commercial centres.[207]

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200 Iraj Hashi, *Financial and Institutional Barriers to SME Growth in Albania: Results of an Enterprise Survey*, Staffordshire University (2001).

201 Centre for Professional Development, *CPD Communicator*, Issue 31, 27 May 2002.

202 C T Sandalford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, The Institute of Policy Studies Wellington (1992) 1.

203 Organisation for Economic Co-operation and Development, *Taxation and Small Business* (1994) OECD, Paris.

204 C Sandford, "Economic Aspects of Compliance Costs", cited in Adrian Sawyer "Compliance Cost Impact Statements in New Zealand – How Far Have We Come" (2002) (17), *Australian Tax Forum*, 449.

205 Mark Pizzacalla, "Australia's SME tax identity crisis" (2007) 22(1) *Australian Tax Forum* 19, 31.

206 Robin Speed, "An internationally competitive tax system for Australia", *Australian Tax Review* (2003) 32 AT Rev 51 at 51.

207 Wachtel M and Capito A, "Removing Tax Barriers to International Growth", *Business Council of Australia*, 11 December 2001 cited in Robin Speed, "An internationally competitive tax system for Australia", *Australian Tax Review* (2003) 32 AT Rev 51. Given that more and more Australian privately held groups are expanding offshore confronting commercial risks not faced in Australia, it is important that the Australian tax system facilitates this transition rather than being yet another barrier to expansion.

Similarly, Australia's small business/SME tax policy should also be measured against that of other developed countries tax regimes. Ultimately, the test will be whether the small business tax regime actually makes small business/SMEs more competitive. This requires more than just ensuring that new laws are simplified and easy to understand and compliance costs modified and reduced as the opportunities present themselves, but rather should be formulated against the backdrop of a well reasoned small business/SME tax policy framework with agreed objectives and outcomes. The continuous monitoring and evaluation of SME tax policies must be a critical part of any SME policy program[208], and needs to be undertaken using a common framework (even if this differs between countries).[209]

Over the years, tax reform in Australia in relation to SMEs has been more about tinkering around the edges and focusing on reducing compliance obligations. Whilst these are welcome changes when they are introduced, this does not constitute tax reform, but the loss of real opportunities for significant changes. In recent times (at least), there really does seem to be a gap between what politicians and business taxpayers view as being tax reform as evidenced by the following commentary in relation to Australia's 2006 Federal Budget:

> The Budget contains the usual rhetoric about simplification and reduction of compliance costs, but there is little in the specific tax measures to encourage the belief that this is truly a tax-reforming budget. Indeed, it is anything but.[210]

On balance, tax literature supports the view that SME tax concessions should first, and foremost, follow the principle of "simplicity".[211] It is important to remember that what can put tax simplification out of reach is a lack of political viability.[212] That is, there needs to be a strong political will to ensure that tax simplification takes precedence over other tax policy (and political) concerns.

Overall, the debates around tax policy in relation to SMEs in Australia are very similar to those highlighted both in the UK and USA. The business environment facing SMEs today is dynamic and fiercely competitive characterized by most of the issues also facing larger companies such as globalisation, internationalisation of markets, complexity of customer needs and wants, and development and protection of intellectual property. This commonality of both commercial and tax issues means that whilst the characteristics of SMEs and their associated issues may not be identical in each jurisdiction, there are opportunities to learn and grow from each other.

The tax policy challenges facing SMEs are inevitably inhibited by the same obstacles facing any tax or regulatory reform, competing vested interests from various taxpayer groups, fears of the consequences of change, and accompanying uncertainty. Optimal approaches to structuring reform resulting from OECD country experiences

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208 OECD, "Best practice policies for small and medium sized enterprises"(1997) 9.

209 OECD, "Best practice policies for small and medium sized enterprises"(1997) 11.

210 Editorial, "Tax Cuts are not Tax Reform", *Australian Tax Review* (2006) 35 AT Rev 89.

211 Mark Pizzacalla, "Australia's SME tax identity crisis" (2007) 22(1) *Australian Tax Forum* 19, 31.

212 Steven A. Dean, "Attractive Complexity: Tax Deregulation, the Check-the-Box Election and the Future of Tax Simplification" (2006) 34 *Hofstra Law Review* 405-467, 406.

suggest that successful policy restructuring requires strong political leadership, communication and selling the reform agenda, implementing comprehensive reform rather than piecemeal reform, optimizing the sequencing of the reform agenda, and international co-operation.[213]

The importance of the SME sector to the Australian economy means that economic policy must take into account the impact of SMEs and that SME specific policies must be developed in a co-ordinated and logical manner rather than being introduced based on populist views of the day. The desire by government to be seen to be doing something at around budget time (generally to appease small business lobby groups) should no longer be considered to be acceptable behaviour and the emphasis should move towards the development of co-ordinated medium to longer term SME tax strategies.

When setting tax policy for Australian SMEs, and SMEs generally, it is recommended that the following parameters be used as a guide:

- **Lowering the overall tax burden.**[214] Many OECD countries have lower corporate tax rates for small firms.[215] As a general proposition, a company that pays a regular dividend to its shareholders owners/investors, irrespective of the stock price, will always be viewed favourably by prospective investors. This is equally true of both large and small companies. Shareholders reap the benefits of receiving cash dividends on a regular basis, and the presence of dividends will help support the market value of the company that is being built.[216] Accordingly, start-ups aside, tax policy should assist SMEs maintain profitability whilst also easing cash flow burdens.[217]

- **More focused approach on developing appropriate SME tax strategies rather than tax compliance.**[218] The tax system should be able to provide a framework to both encourage people to take the risk and start up

213 OECD, "The OECD Report on Regulatory Reform" (1997), 24-27.

214 William M. Gentry and R. Glenn Hubbard, "Tax Policy and Entrepreneurial Entry", (May 2000) *The American Economic Review* 283. Robert Carroll, Douglas Holtz-Eakin, Mark Rider, Harvey S. Rosen, "Personal income taxes and the growth of small firms" (2000) *National Bureau of Economic Research*, Working Paper No 7980.

215 OECD, "Entrepreneurship and growth: tax issues" (2002) 8-9.

216 Trevor Hoey, "Smaller companies, bigger yields", *Australian Financial Review, Portfolio Liftout*, 28 March 2007.

217 For example, concessions provided by way of accelerated depreciation allowances would achieve this dual goal.

218 Professor Francis Chittenden, Dr Saleema Kauser and Dr Panikkos Poutziouris, "Regulatory Burdens of Small Business: A Literature Review." (Manchester Business School, The University of Manchester). This paper provides a critical review of the literature on the impact of government regulations on small firms in the USA, the UK, the EU, Australia, and New Zealand. The results are not surprising with the burden of compliance falling more heavily upon smaller firms compared to larger firms, and governments unable to come to terms with how to reduce such costs for small firms in a substantive way.

a business, as well as providing further incentives along the way to those who succeed in their ventures. This involves having a more detailed understanding in relation to the composition of the SME sector, as well as the potential impact that changes in tax policy may have.

- **Increase investment tax incentives and initiatives for SMEs.** These types of initiatives more strongly influence SME investment decisions vis-à-vis larger businesses.[219]
- **Encourage retention of taxable profits.** In this way, profits may be reinvested into the business by SME owners helping to establish a capital base, instead of using the monies personally.[220]. The implications for SME owner remuneration will need to be considered as part of this process.[221]
- **Increase management and employee tax participation incentives.** In particular, increasing the tax free movement of capital when introducing new people into the business via share plans. Currently, this is stifled by Australia's CGT General Value Shifting equity provisions.[222]
- **Allow small businesses access to a higher R & D concession rate vis-à-vis larger businesses**.[223] (As a more general observation, whilst business spending on R & D has continued to rise over the seven year period to 2005-06, Australia still lags behind the OECD average R & D spend.)[224]
- **Increase simplicity in the tax law**. Any new tax laws introduced should adopt this as a fundamental principle. This has been sadly lacking in

219 Lynn Neeley, "Small business, capital investments and tax reform" (1992) 30(3) *Journal of Small Business Management* 30, 33.

220 Francis Chittenden, Panikkos Poutziouris, and Tim Watts, "Taxation and small firms: creating incentives for the re-investment of profits"; Professor Francis Chittenden, Dr. Panikkos Poutziouris, and Dr. Nicos Michaelas, "Small Business Taxation: An Agenda for Growth" (2000) Manchester Business School 3.

221 Robert Watson, "Employment change, profits and directors" remuneration in small and closely-held UK companies' (1990) 37(3) *Scottish Journal of Political Economy* 259. P Poutziouris, F Chittenden and N Michaelas, "Evidence on the Tax and Investment Affairs of Small Firms" (1999) 6(1) *Small Business and Enterprise Development*.

222 Australia's General Value Shifting regime was introduced effective 1 July 2002 and is contained in Div 725 of the ITAA 1997. In most cases, the consequence will be an adjustment of cost bases, but in some cases may result in taxable income, or a taxable capital gain. There are deminimus thresholds to ensure that the provisions capture substantial value shifts (ie. value shifts must be at least AUD$50,000).

223 Sophie Morris, "Rethink on R & D funds urged", *Australian Financial Review*, 27 March 2007, 3. Sophie Morris, "Hopes up for R & D investment incentives", *Australian Financial Review*, 13 April 2007, 26 . Tony Blackie, "Beyond the far horizon", *Business Review Weekly*, 10-16 May 2007, 24.

224 Gina McColl, "Business R & D spending tops $10bn", *Business Review Weekly*, 13-19 September 2007, 65.

> Australia's changing tax landscape. This is also evidenced by the fact that Australian taxpayers are regarded as arguably the most tax agent dependent taxpayers in the world.[225]

Unfortunately, however, there is little by way of objective evidence to suggest that there is a strategic approach being adopted by any of the governments in relation to the taxation of small business. As is so often the case, any proposed tax changes that may bring about the greatest benefits to SMEs are usually the most politically difficult to achieve.

225 Margaret McKerchar, "The Impact of Income Tax Complexity on Practitioners in Australia" (2005) 20(4) *Australian Tax Forum* 529, 532.

Table 1 – Australia's Major tax reforms and SME Outcomes

Year	Tax Reform Process/Report	Description	SME Outcomes
1975	The Asprey Report	Australia's first ever public inquiry into the operation of the taxation system.	No SME outcomes.
1985	Draft White Paper	This report resulted from the Tax Summit organised by the Hawke/Keating government.	Did not specifically address SMEs as a taxpayer category, but did consider some common SME tax issues.
1988	Beddall Committee	First ever inquiry in relation to small business by a Federal Parliamentary Committee.	Predominately focused on regulatory and compliance outcomes, rather than overall SME tax policy strategy.
1995	Senate Economics References Committee	Established by the Australian Senate with specific terms of reference in relation to small business tax issues.	Focused on making recommendations to counter disadvantages faced by small business in relation to tax compliance related issues.
1996	Small Business Deregulation Task Force	Established to review the compliance and paper burden on small business.	This committee was specifically directed by the government to not consider tax policy and to only look at revenue neutral ways to assist SMEs.
1998	Not a New Tax, A New Tax System	Introduction of GST, effective 1 July 2000.	Special Small Business Consultative Committee established to ensure small businesses not financially disadvantaged by the GST in the start up phase.
1993-1999	Tax Law Improvement Project	Attempted rewrite of the Income Tax Assessment Act 1936.	No specific SME outcomes. This process was abandoned with only one-third being completed and has now resulted in two Acts of Parliament being in force.
1999	Review of Business Taxation	This review was based on the Howard Government's A New Tax System and considered the adequacy of Australia's income tax policy, legislation and administrative processes.	Two important outcomes of the Ralph Review specifically directed at small business were: • the introduction of the STS regime (July 2001); and • range of CGT concessions available on disposal.

Year	Tax Reform Process/Report	Description	SME Outcomes
2000	Entity Taxation	Exposure Draft – New Business Tax System (Entity Taxation) Bill 2000 was released aimed at taxing certain trusts like companies.	The draft legislation was withdrawn by the government in February 2001 on the basis that the provisions had technical problems and were unworkable.
2007	Alignment of the concession thresholds for small business – consultation with Treasury	Realignment of the definition of small business.	Streamlining of the small business definition as the sole basis for accessing small business tax concessions.