

INTRODUCTION

THE IMPORTANCE OF SMALL BUSINESS

Definitions

1.1 The Australian Bureau of Statistics defines a small business in the non-agricultural sector as one which employs less than 20 employees in the non-manufacturing industries, and less than 100 employees in the manufacturing industries. In the agricultural sector, a small business is defined as one having an Estimated Value of Agricultural Operations of between \$20,000 and \$399,000. Smaller operations are considered to make a negligible contribution to commodity aggregates.

1.2 Using this definition, small businesses account for about 860,000, (96%) of all businesses in Australia, and employ about 3 million out of 5.5 million people employed in the private sector. Of these enterprises, 635,000 (74%) employ fewer than five people.

1.3 The Australian Tax Office defines a small business as an entity (including self-employed individuals) that returns business income of less than \$10 million. The latest data on returns lodged reveals that there were a total of 1,662,188 such entities in the 1992-93 year of income, of which 1,230,830 (74%) were individuals or partnerships.

The Importance of Small Business

1.4 Whichever definition is used, it is clear that small businesses form a significant part of the Australian economy, providing employment for millions of Australian. Indeed, the significance of small business in Australia is underscored in a recent report by the Industry Task Force on Leadership and Management Skills which reveals that Australia is notable for the small number of world scale enterprises which it supports. Only 600 enterprises in Australia employ more than 1,000 people, which is a tiny number by the standards of the major trading nation.

1.5 According to research prepared for the Industry Task Force, small firms in Australia have been the source of almost all private sector employment growth since 1991. The Task Force predicted that most new jobs created in Australia up to the year 2000 will be generated by small to medium enterprises (SMEs).

1.6 With unemployment still a major problem facing the Australian community, support for the important SME Sector takes on added meaning, especially because the potential for SMEs to become increasingly important contributors to Australia's expanding export base.

The Beddall Committee Report

1.7 In January 1990, the House of Representatives Standing Committee on Industry, Science and Technology tabled its report, *Small Business in Australia: Challenges, Problems*

and Opportunities (the Beddall Report). That Committee expressed the belief that although there were concerns raised about almost every aspect of Commonwealth taxation, the most pervasive and most important complaints had been about the rapid growth in the size and complexity of taxation law, the complex and uncoordinated administrative systems which support it, and the associated compliance and reporting costs which are particularly onerous for small business.'

1.8 The recommendations made by the Beddall Committee reflected some fundamental small business perceptions as presented to it, one of which was that tax law and administration do not consider the operating environment of small (vis a vis large) business and, in particular, the working capital restrictions experienced by small business. The Beddall Committee noted that increases in taxation reporting and awareness costs had a disproportionate impact on smaller businesses because of:

- economies of scale, which apply to larger businesses in establishing a specific purpose accounting/reporting function to comply with taxation requirements, do not apply to small businesses; and
- the inability of many owner operated businesses to bring the costs of taxation compliance to account as a tax deduction against income. For example, the cost to a larger business of employing an accountant is offset by the fact that that cost is a fully allowable deduction against taxable income. A smaller business may not be able to afford an accountant without sacrificing other management/advisory services for which the business depends upon for its viability and will need to absorb the costs of compliance by requiring the owner/manager or his/her spouse to perform these tasks.

1.8 The Senate Economics Committee found during the course of its inquiry into the tax treatment of small business that although the implementation of some of the recommendations of the Beddall Committee report had been of considerable benefit to the small business community, some of the taxation problems encountered by small business remained essentially unchanged. This report attempts to address these concerns.

This Report

1.9 The Committee believes 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.

1.10 Therefore, the fundamental approach used in this report, and expressed through its recommendations, is to attempt to counter the disadvantage of the size of a small business operation. Unless otherwise stated, the definition of small business employed by the ABS will be used.

1.11 The Committee considers that small businesses should not be considered to be on the same footing as larger businesses in relation to much of the current tax legislation, and that affirmative action needs to be taken to redress some of these deficiencies. Some of measures recommended in this report will be revenue neutral. Others, however, will not be revenue neutral in the short term, as they are targeted to assist small businesses to enhance their operations and increase business outputs, profits and employment. In the long-term, these measures should increase taxation revenue.

Legislation

The terms of reference for this inquiry are primarily concerned with various provisions contained in the *Income Tax Assessment Act 1936* (the **ITAA**), the *Fringe Benefits Tax Assessment Act 1986* (the **FBT**) and the *Sales Tax Assessment Act 1993*. Tax changes introduced by and since the 1993 Budget until the end of 1994 include:

- * *Taxation (Deficit Reduction) Act (No 1) 1993*
- * *Taxation (Deficit Reduction) Act (No 2) 1993*
- * *Taxation (Deficit Reduction) Act (No 3) 1993*
- * *Taxation Laws Amendment Act (No 3) 1993*
- * *Income Tax (Franking Deficit) Amendment Act 1993*
- * *Taxation Laws Amendment Act 1994*
- * *Taxation Laws Amendment Act (No 2) 1994*
- * *Taxation Laws Amendment Act (No 3) 1994*
- * *Taxation Laws Amendment Act (No 4) 1994*
- * *Income Tax (Deficit Deferral) Act 1994*
- * *Training Guarantee (Administration) Amendment Bill 1993*
- * *Sales Tax Assessment Amendment (Deficit Reduction) Act 1993*
- * *Sales Tax (Customs) (Deficit Reduction) Act 1993*
- * *Sales Tax (Customs) (Wine - Deficit Reduction) Act 1993*
- * *Sales Tax (Excise) (Deficit Reduction) Act 1993 Sales Tax (Excise) (Wine - Deficit Reduction) Act 1993*
- * *Sales Tax (General) (Deficit Reduction) Act 1993*
- * *Sales Tax (General) (Wine - Deficit Reduction) Act 1993 Sales Tax (In Situ Pools) (Deficit Reduction) Act 1993.*

* *Sales Tax (In Situ Pools) (Deficit Reduction) Act 1993*

The Tax Treatment of Small Business

1.12 There are a number of taxes affecting small (and large) businesses, including provisional tax, wholesale sales tax (WST), pay-as-you-earn (PAYE) tax, fringe benefits tax (FBT), prescribed payments system (PPS), capital gains tax (CGT), company tax and superannuation guarantee (SG).

1.13 All small businesses in Australia must comply with at least one and frequently several of these taxes. As the following chapters illustrate, none of these taxes in themselves are simple, and when three or four different taxes apply to the one business, compliance may become a considerable burden on the operation of that business.

1.14 Part 1 of this report discusses each Commonwealth tax that may affect a small business and Part 2 assesses the cumulative impact of multiple taxes on small business, which results in a considerable burden of compliance.