IPA INSTITUTE OF PUBLIC ACCOUNTANTS

23 September 2016

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Senate Economics Legislation Committee
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Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016

The IPA welcomes the opportunity to provide a submission on Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016. The bill amends the *Income Tax Rates Act 1986* to reduce the corporate tax rate for small businesses with an aggregated turnover of less than $10 million to 27.5 per cent for the 2016–17 financial year and progressively extends that lower rate to all corporate tax entities by the 2023–24 financial year; and further reduces the corporate tax rate in stages so that by the 2026–27 financial year, the corporate tax rate for all entities will be 25 per cent. The bill also amends *Income Tax Assessment Act 1997* to increase the small business income tax offset to 16 per cent of an eligible individual's basic income tax liability that relates to their total net small business income from the 2026–27 financial year; and enables small businesses with an aggregated turnover of less than $10 million to access most small business tax concessions, and small businesses with an aggregated turnover of less than $5 million to access the small business income tax offset.

The IPA is a professional organisation for accountants who are recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 35,000 members and students in Australia and in more than 80 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice. More than 75

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per cent of our members work in or with small business and SMEs and are recognised as the trusted advisers to these sectors.

As the Institute of Public Accountants main focus is on the SME sector, we will limit our submission to the proposed tax relief measures in the Enterprise Tax Plan for small and medium businesses, specifically those with turnovers of up to $10 million.

The IPA does however support the long term move to more competitive tax rates for larger businesses and multinational companies to encourage such entities to invest, remain and expand in Australia. The 10 year plan to a 25 per cent tax rate still puts Australia slightly above the OECD average assuming other countries do not further lower their corporate tax rates within the next ten years. For Australia to remain competitive as an investment destination, it cannot afford to completely abandon its corporate tax rate reduction plan when countries we compete with have a lower corporate tax rate.

Pragmatic politics and fiscal budget circumstances may for the short term prioritise tax relief in favour of small employers who account for the largest share of total employment in Australia. Having regard to the importance of small businesses in the Australian economy who employ some 44 percent of total employment, we support the short term compromise, if it meant the Bill could successfully progress through Parliament without granting tax relief for entities with turnover in excess of $10 million. Tax relief for large entities might have to wait as there seems little chance that these reforms will pass the Senate and their inclusion in this Bill will be at the detriment of the other tax relief measures for smaller entities.

The contribution of small businesses to productivity and economic growth is well recognised. Small businesses can exhibit greater flexibility and responsiveness to changing markets than large businesses. Small businesses can also be highly innovative and dynamic, tapping into niche markets, responding to changing consumer preferences and contributing to the development and diffusion of new technologies. We agree with the Government that providing more tax relief to SMEs will generate a growth dividend to the economy in the form of potentially increased employment, higher wages and removing disincentives to business growth caused by the turnover threshold. The current low threshold discourages growth as entities lose access to tax concessions once they pass the threshold.

Although small businesses are an important source of employment, small businesses with turnover of less than $2 million tend to be non-employing, have very few employees or are mainly operated by family members. According to ABS data, around 61 per cent of actively trading small businesses are non-employing, while around 28 per cent of actively trading small businesses have between one and four employees and 10 per cent between 5 and 19 employees. Moving the tax threshold for access to small business concessions to entities up to $10 million can potentially contribute to more employment as such entities are already employing entities. The revenue foregone is likely to be substantially covered by the economic benefits from increased employment, higher wages and lower compliance costs.

Small businesses face significant impediments to participation in economic markets, due to high barriers to entry and exit and difficulties in obtaining access to finance. Other challenges for small businesses in Australia can arise from high compliance costs and regulatory burden which tend to disproportionately affect small businesses. The time and effort required to comply with tax obligations, in particular, are reported to account for a major portion of small businesses' total compliance costs. In addition small businesses are typically more vulnerable than larger businesses to shocks and changes in economic conditions. For this reason they have a higher failure rates in comparison to larger businesses. It is for these reasons that extending tax relief for SMEs is warranted.

Specific comments in relation to Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016 legislation is as follows:

Increase Small Business Turnover Threshold

On 1 July 2007, the concept of an STS taxpayer was replaced by a 'small business entity' definition, being any small business with an annual turnover of up to $2 million. As a result, small businesses only have to meet the 'small business entity' test to access the full suite of small business tax concessions (subject to any additional criteria set out in the particular concessions).

Currently the following tax concessions that are available to small business entities are:

- Immediate deductibility for small business start-up expenses;
- Simpler depreciation rules;
- Simplified trading stock rules;
- Roll-over for restructures of small businesses;
- Deductions for certain prepaid business expenses immediately;
- Accounting for goods and services tax (GST) on a cash basis;
- Annual apportionment of input tax credits for acquisitions and importations that are partly creditable;
- Paying GST by quarterly instalments;
- Fringe benefits tax (FBT) car-parking exemption;
- Pay-As-You-Go (PAYG) instalments based on gross domestic product (GDP) – adjusted; and
- Access to the lower corporate tax rate.

The $2 million turnover threshold was introduced in 2007 and it has not been indexed since. The Board of Taxation recommended an increase to the threshold in their 2014 *Review of the Tax Impediments Facing Small Business*, stating that increasing the threshold would reduce the number of businesses who are at or near the current threshold and so face uncertainty as to their tax treatment. An increase to the threshold was also recommended in the *Australia's Future Tax System Review (Henry review)* in 2009.

Increasing the threshold would also assist businesses, with a higher aggregated turnover but low margins, to access the concessions. It is estimated that increasing the threshold would allow an additional 90,000 to 100,000 businesses access to the small business tax concessions, decreasing their compliance costs and increasing cash flow. This would enable greater reinvestment in small businesses

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and provide the opportunity for these businesses to increase employment and increase wages. It would also provide incentives for small businesses at or near the existing $2 million turnover threshold to grow, as currently they would lose these concessions once they passed the threshold.

Of particular interest to entities with turnover above the existing threshold limit is access to simpler depreciation rules, lower corporate tax rate and also the newly enacted small business roll-over restructure relief. The simpler depreciation rules allows such entities to access the small asset write-off entitlements. Small business can immediately write-off and deduct most depreciating assets that cost less than $20,000 each that were bought and used, or installed ready for use from 12 May 2015 until 30 June 2017. Depreciating assets costing $20,000 or more can be placed in a small business asset pool and the entity can claim:

- a 15% deduction in the first year (regardless of when you purchased or acquired them during the year)
- a 30% deduction each year after the first year

The small business restructure rollover (SBRR) allows small businesses to transfer active assets from one entity (the transferor) to one or more other entities (transferees), on or after 1 July 2016, without incurring an income tax liability. The SBRR is intended to make it easier for small businesses to adopt, or evolve, into a more appropriate legal structure when necessary without incurring tax liability on the transfer.

The IPA supports allowing small businesses with aggregated turnover of less than $10 million access to the small business tax concessions, and small businesses with aggregated turnover of less than $5 million access to the small business income tax offset.

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Increase to the tax discount for unincorporated small businesses

Reducing the corporate tax rate further for incorporated small businesses means that 2.3 million small businesses would not receive any similar tax relief as they are not operated through a company. Approximately 70 per cent of small businesses are unincorporated.

From the 2015/16 income year, the Government introduced small business entity tax offset which provides unincorporated small businesses with a tax discount broadly equivalent to the small business company tax rate cut of 1.5 per cent that was also introduced in the 2015-16 income year. The small business tax offset entitles individuals who are small business entities, or who are liable to pay income tax on a share of the income of a small business entity, to a tax offset equal to 5 per cent of their basic income tax liability that relates to their total net small business income, capped at $1,000. The IPA was a strong advocate for the introduction of such an offset to address the regressive nature of compliance costs on small business entities.

Given further cuts to the small business company tax rate, it is entirely appropriate that further increases to the tax discount provided by the offset are made. This minimises tax distortions between the different entity types through which small businesses may be run, and ensures that the many small businesses run through unincorporated entities also receive an increase in their cash flow from tax relief. The legal structures used by small businesses vary significantly. According to ATO statistics, around 36 per cent of identified small businesses operate as sole traders, around 13 per cent as partnerships, 23 per cent as trusts and 28 per cent as companies. The legal structure of a small business can significantly affect its tax obligations, interactions with the tax system and eligibility for available tax concessions.

The relationship between the changes in the discount rate and the corporate tax rate applying to small businesses are summarised in the following table:

Income year/s	***Rate of small business income tax offset***	***Corporate tax rate applying to small businesses***
2015-16	5 per cent	28.5 per cent
2016-17 to 2023-24	8 per cent	27.5 per cent
2024-25	10 per cent	27 per cent*
2025-26	13 per cent	26 per cent*
2026-27 and later income years	16 per cent	25 per cent*

Further increases in the unincorporated tax discount for small businesses is consistent with the original policy intent for the small business tax offset.
By increasing the tax discount for unincorporated small businesses, it will provide increased cash flow to profitable unincorporated businesses. Unincorporated small business owners will have higher after-tax earnings which they will be free to reinvest in their businesses.

Unfortunately, although these increases in the offset will increase the amount of offset an eligible individual may claim, the offset will remain capped at $1,000. The small business tax offset of $1,000 needs to be also raised over time to mirror the tax relief available to incorporated entities from further company tax cuts in line with the original policy intent for the tax offset.

We do however support the change from $2 million to $5 million turnover threshold for the small business tax offset.

The IPA welcomes the opportunity to discuss further any of the matters we have put forward in our submission. Please address all further enquires to myself

Yours sincerely,

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