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Indirect Tax Legislation Amendment (Small Business Measures) Bill 2004

Michael Priestley
Economics, Commerce and Industrial Relations Section

Jennifer Nicholson
Law and Bills Digest Section

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Indirect Tax Legislation Amendment (Small Business Measures) Bill 2004

Date Introduced: 24 June 2004

House: House of Representatives

Portfolio: Treasury

Commencement: On Royal Assent. However, in some cases an election made under this legislation will take effect from 1 July 2004.

Purpose

To amend the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) to:

- provide small businesses and non-profit organisations that are voluntarily registered for the GST the option to report and pay GST on an annual basis,
- allow small businesses to elect to undertake annual apportionment of input tax credits for acquisitions used partly for non-business purposes (rather than being required to apportion credits on a monthly or quarterly basis), and
- remove the requirement for an eligible entity to make an annual election to pay GST by instalments.

Background

As part of the 2004-05 Federal Budget, the Treasurer announced changes to small business compliance with the GST, in particular to the GST reporting and payment arrangements:

Assisting small business

Mr Speaker, a big part of our resilient economy is our resilient small business. To reduce the compliance burden on small business, tonight I am announcing measures which will allow small businesses who are below the registration threshold and voluntarily registered for GST to report and pay GST annually, instead of quarterly.

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These measures will benefit around 740,000 small businesses and 30,000 non-profit organisations that are voluntarily registered and currently pay on a monthly or quarterly basis. As all GST revenue is paid to the States, their approval of these changes will be required. The Government will offer to compensate the States for the revenue deferred in this measure at a cost of \$330 million in 2004-05.¹

In addition to the above change in GST compliance, small businesses with an annual turnover of \$2 million or less would be allowed to apportion their private and business use of assets, such as motor vehicles on an annual basis for GST purposes rather than on a quarterly or monthly basis.² The Treasurer also announced that businesses that elect to pay their GST through quarterly instalments would not be required to re-elect in the following years.³

The Bill amends the GST Act to give effect to the GST compliance changes announced by the Treasurer. A summary of the changes is discussed in the Main Provisions section. Other recent measures to reduce compliance costs include the small business tax simplification changes announced in the 2004-05 Federal Budget and the *Committed to Small Business* package.⁴

Compliance costs for small business

In a 2001 report, *Businesses' Views on Red Tape: Administrative and Regulatory Burdens on Small and Medium-Sized Enterprises*, the OECD, with the assistance of a business survey by the Australian Chamber of Commerce and Industry (ACCI), estimated that taxation, employment and environmental regulations imposed more than \$17 billion in compliance costs on small and medium-sized businesses in Australia in 1998. Of these costs, employment and taxation regulations accounted for 76 per cent of the total. The OECD report estimated from the survey that Australian businesses incurred compliance costs averaging \$33 000 annually.⁵

An earlier survey of small business (excluding medium-sized businesses in the OECD survey) conducted for the Government's Small Business Deregulation Task Force in 1996 found that on average small business spent 16 hours a week on administration and compliance activities. Of this, government paperwork and compliance accounted for around four hours per week. Taxation matters took up three hours of these hours and one hour was spent on other activities. On average, total compliance costs were \$7000 a year. Of this, almost half (\$3000) was spent on external advice.⁶

In addition the Small Business Deregulation Task Force found that the duplication of information requirements and delays in processing and approvals contributed to a sense of frustration felt by small businesses and a loss of business confidence. (See [Time for Business](#), Report of the Small Business Deregulation Task Force.) It defined the regulation and paperwork burden not just in terms of the financial cost to small business but of lost opportunities which can result in a less productive economy:

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Burden is the additional paperwork and other activities that small business must complete to comply with government regulations. It is the time and expense outlaid that is over and above normal commercial practices. The burden includes lost opportunities and disincentives to expand.

Recent initiatives and reform proposals

The progress towards reducing compliance costs for small business is well documented in the 2003 OECD report, *From Red Tape to Smart Tape: Administrative Simplification*. The report examined administrative simplification in OECD countries and reviewed in detail the policies in seven countries, including Australia. The report noted that the reduction of the impact of regulation on small business has received special attention by all Australian governments over the last few years, beginning in 1995 with the National Competition Policy (NCP) reviews of legislation and reforms to the taxation system:

It is clear that the most important and effective burden reduction programmes in Australia have increasingly been adopted as part of broader reform initiatives, including the ABN element of the recent redesign of the tax system and regulatory quality assurance requirements adopted as part of the implementation of the national competition policy.⁷

In dealing with the compliance burden on small business, governments have focussed on improving the quality of new regulation. At the Commonwealth level, this work is being done by the Office of Regulation Review (ORR) which is the Government's watchdog over the regulation review process.⁸ There is a strong emphasis on small business in the requirements placed on Commonwealth departments and agencies. The Cabinet-endorsed *Guide to Regulation* advises all agencies that:

The Government has asked the ORR to ensure that particular effects on small businesses of proposed new and amended legislation and any other regulation are made explicit in the RIS [Regulation Impact Statement]. The RIS should also give full consideration to the Government's objective... of minimising the paperwork and regulatory burden on small business.

Over the last five years about 900 RISs were required for regulatory proposals affecting business.⁹ Of these, about 750 (or 82 per cent) were assessed by ORR as providing 'an adequate level of analysis'. Most of these RISs were published as part of explanatory material to new legislation. The analysis of the impact of the current Bill on small business is typical of the analysis provided in the RISs. (See [Explanatory Memorandum](#), Regulation Impact Statement, Analysis of costs/benefits.)

The ACCI, which is the peak body representing small business, has described efforts to reduce the compliance burden as a never ending battle and called for greater regulatory accountability. It has proposed a Charter of Mutual Regulatory Responsibility between policy makers who make new regulation and those who have to work under the system.¹⁰ Other organisations representing small business, such as CPA Australia and the Australian

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Industry Group have addressed the need for a Small Business Advocate to act on behalf of small business within government.¹¹

Small business issues and impacts

In a speech to the Small Business Coalition in Canberra, the Chairman of the Productivity Commission, Gary Banks, noted that the burden of regulation fell more heavily on small business not because they are more heavily regulated but because they have the least capacity to cope:

Operators or managers of smaller businesses are less likely to have specialist staff with detailed knowledge of regulations or taxation matters. Regulations are more likely to be dealt with by prime decision-makers, distracting them from their core role. The costs of such managerial diversion are very difficult to assess, but are potentially large.¹²

Indeed, most small businesses (including non-employing small businesses which make up almost 50 per cent of the total number of registered small businesses) do not have the time nor the skills to sift through legislation and have to pay advisers, for example accountants, for assistance. CPA Australia estimates that the compliance burden by small business is at least 35 per cent greater than for large businesses.¹³ The most time consuming activities for small businesses are information exchanges which occur when a business starts up, when circumstances change and when it has to provide periodic reports and returns to government. It is a view that is confirmed by the Chief Executive of the Council of Small Business Organisations in Australia (COSBOA):

Opening a bank account, moving a telephone number, registering a business name, applying for innumerable licences, all of these take time and cost money and divert business owners from developing their business and serving their customers... Red tape impacts disproportionately on small businesses because they do not have the money or staff to devote solely to compliance tasks. There is a physical limit to how much compliance a small business can do and stay afloat.¹⁴

Is the burden on small business increasing?

A number of small business organisations, including the State Chamber of Commerce (NSW), have undertaken surveys on the small business compliance burden. Although the surveys do not purport to measure systematically the cost of compliance as was measured by the Small Business Deregulation Task Force in 1996, these point to an increase in the compliance burden faced by small business.

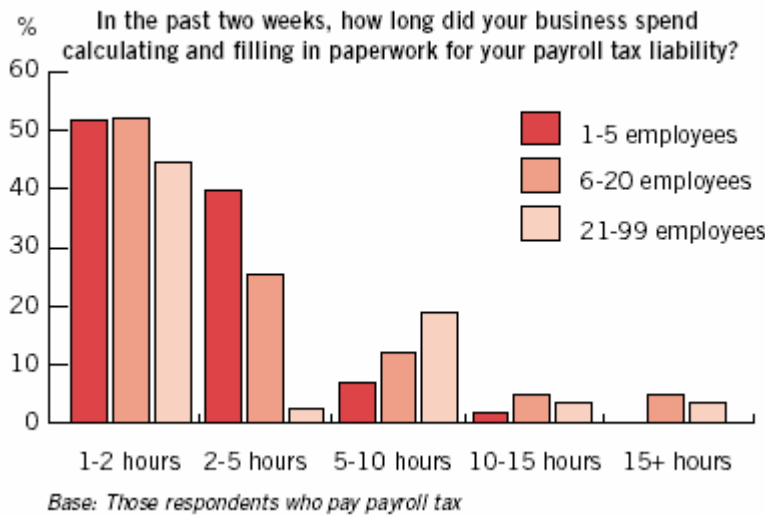
The survey by the State Chamber of Commerce (NSW), which was undertaken in July 2003, found that small businesses face proportionately higher compliance costs both in time and resources than large businesses. (See [Red Tape Register - the Tax Burden.](#)) The survey examined the costs for businesses in complying with employment (payroll) and tax

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related regulation only. Typically, most small and micro businesses (businesses with less than 5 employees) spend 1 to 2 hours a fortnight on payroll related paperwork. This is the same amount of time taken by large businesses with 21 to 99 employees (see chart below). There is very little relationship between the number of employees and the time a business spends in calculating its payroll liability.



A similar conclusion can be drawn for the quarterly GST returns and associated Business Activity Statement (BAS). The most common time spent by businesses for BAS statement completion was 5 to 15 hours a quarter. However, 10 per cent of all businesses took 31 to 50 hours or more (that is 4 to 6 days a quarter).



In a survey of businesses in the retail motor industry by the Victorian Automobile Chamber of Commerce, 86 per cent of respondents indicated that the compliance burden

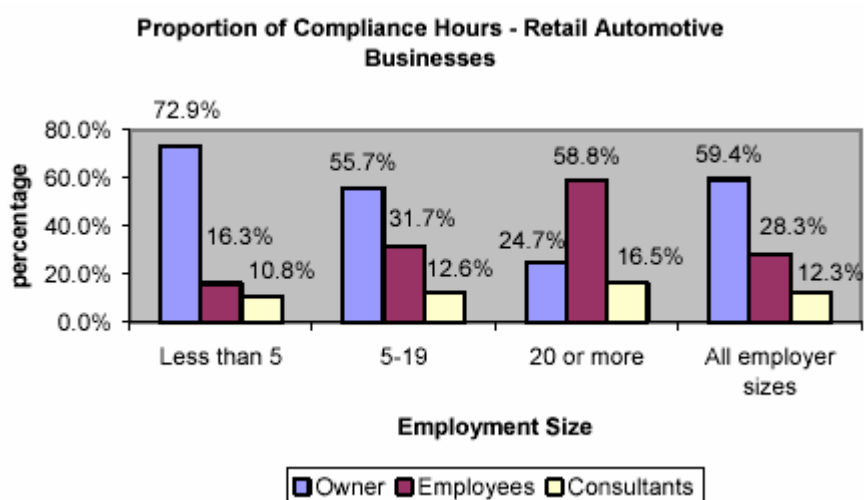
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had increased over the past five years. (See [Survey of Business Compliance Costs](#).) There was no marked difference in the response across the three business categories. Large businesses with 20 or more employees and small businesses with 5 to 19 staff reported an increased compliance burden (90.0 per cent and 89.5 per cent respectively), compared with 81.9 per cent for micro businesses (those with less than 5 employees).

Not surprisingly, the increased compliance burden had fallen largely on business owners. Of the hours that businesses in general spend on compliance activities, business owners undertook 59.4 per cent, employees performed 28.3 per cent and consultants completed the remaining 12.3 per cent of compliance tasks (see chart below).



Main Provisions

Schedule 1 – GST lodgment and payment

Item 6 of Schedule 1 inserts **Division 151 – Annual tax periods** into the GST Act. This Division allows certain entities to have annual tax periods and to lodge their GST returns and pay their GST on an annual basis.

Entities may elect to report and pay GST on an annual basis

Subdivision 151-A (**sections 151-5 to 151-25**) sets out the rules and procedures for a small business or non-profit organisation that is voluntarily registered for the GST to make an *annual tax period election*. A registration threshold will apply and only those entities with an annual turnover below the threshold (\$50 000 for businesses and \$100 000 for non-profit organisations) will be eligible to make an annual tax period election. If an entity is required to be registered for GST purposes then it cannot make an annual tax period

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election. Generally, an election must be made on or before 21 August for those entities with monthly tax periods, and on or before 28 October for those with quarterly tax periods.

Under **section 151-25** an election may be disallowed by the Commissioner. A decision to disallow is a reviewable decision under the *Taxation Administration Act 1953* (the Administration Act).

Schedule 2 – Creditable purposes – Input Tax Credits

Item 11 of Schedule 2 inserts **Division 131 – Annual apportionment of creditable purpose** into the GST Act. This Division allows small businesses to elect to determine their non-enterprise or private use of acquisitions on an annual basis when claiming input tax credits, rather than on a quarterly or monthly basis as is currently the case.

Election to have annual apportionment

New subdivision 131-A (sections 131-5 to 131-20) sets out the rules and procedures to enable an entity to make an *annual apportionment election*. An entity will be eligible to make an election if its annual turnover does not exceed the *annual apportionment threshold* of \$2 million and the entity is not subject to either the GST instalment or annual tax period options. Once a valid annual apportionment election has been made, it will continue to apply unless the entity revokes the election.

Under **section 131-20** an annual apportionment election may be disallowed by the Commissioner. A decision to disallow is a reviewable decision under the Administration Act.

New subdivision 131-B (sections 131-40 to 131-60) deals with the consequences of an annual apportionment election.

Under **section 131-40** where an annual apportionment election has been made the input tax creditable on an acquisition that is partly creditable (generally because partly for business use and partly for non-business use) is equal to the GST payable on the acquisition.

Section 131-45 makes a corresponding provision in relation to importations.

In relation to both acquisitions and importations, there is provision for regulations to be made if the operation of these provisions gives rise to practices that are inconsistent with the policy intent.

New **sections 131-55** and **131-60** provide that an entity will have an *increasing adjustment* where the amount of input tax credit is determined under new **subdivision 131-B** and is different to what it would have been had that subdivision not applied.

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Schedule 3 – Payment of GST by instalments

Entities that have an annual turnover of \$2 million or less and meet certain other criteria can elect to pay their GST in quarterly instalments. These entities are currently required to make a new election each financial year in order to continue paying GST by instalments. **Schedule 3** of the Bill removes this requirement.

Instalment election

New **subsection 162-30(1)** provides that once a GST instalment election has been made, it will continue to apply unless the entity revokes the election, the Commissioner disallows the election, the entity's annual turnover exceeds the instalment turnover threshold or the entity is in a net refund position. A decision to disallow an election is a reviewable decision under the Administration Act.

Endnotes

- 1 This change will result in a deferral of GST revenue to the States and Territories, including \$330 million in 2004-05 and between \$16 million to \$18 million in subsequent years.
- 2 See Budget Paper No 3, [Appendix A: GST Revenue Measures](#).
- 3 See Joint Press Release, "[Small Business Tax Simplification](#)", Treasurer and Minister for Small Business and Tourism, 11 May 2004.
- 4 See Joint Press Release, "[Small Business Tax Simplification](#)", Treasurer and Minister for Small Business and Tourism, 11 May 2004; and Media Release, "[Reduced Paperwork for Small Business](#)", Minister for Small Business and Tourism, 6 July 2004.
- 5 The figure is slightly under the OECD average of \$36 300.
- 6 See Yellow Pages, *Working Overtime - A National Survey of the Paperwork Burden on Small Business*, Background Paper 3, October 1996.
- 7 OECD, *From Red Tape to Smart Tape: Administrative Simplification in OECD Countries*, 2003, p. 105.
- 8 It also has a similar role for COAG in relation to national regulatory proposals. For its Charter and Functions see [Office of Regulation Review, Charter](#).
- 9 See Office of Regulation Review, [Regulation and its Review 2002-03](#), Compliance trends since 1998, pp. xvii-xxi.
- 10 See Australian Chamber of Commerce and Industry, [Threats to Small and Medium sized Enterprises from Tax and other Regulations](#), 22 August 2003.

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- 11 See Australian Industry Group, Media Release, “[Small business need more from both sides](#)”, 7 July 2004; and CPA Australia, [Small Business Policy: where to from here?](#), Discussion Paper, pp. 9–10.
- 12 Gary Banks, [Reducing the business costs of regulation](#), 20 March 2003, p. 5.
- 13 CPA Australia, [Small Business Policy: where to from here?](#), Discussion Paper, p. 7.
- 14 AAP, *Australian small business buried in red tape*: COSBOA, 20 July 2004.

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