THE INFLUENCE OF TAX REFORM ON ENTREPRENEURSHIP AND MANAGEMENT PRACTICES IN THE SMALL BUSINESS SECTOR IN AUSTRALIA

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Extensive tax reform has been ongoing in Australia since 1985 and many of these reforms have had major impact on the reporting requirements for small businesses. The vast majority of businesses in Australia are small businesses and they are a major source of employment and economic activity. Less regulation and a more sound understanding of small businesses could allow owners to give greater attention to being entrepreneurial, to better manage their cash and other liquid assets, and to implement more effective management practices. Communication, a shared vision, and a commitment to clear, consistent and integrated policies by governments are needed.

I INTRODUCTION

This paper provides a review of the effect of tax reform on entrepreneurship and management practices in the small business sector in Australia and identifies areas where policymakers and governments could provide further support to the sector. Small businesses play a major role in Australia because of the level of employment that they generate and their contribution to the economy. Since 1985 there has been continual and extensive reform of the Australian taxation system. Many of these reforms have directly, and quite profoundly, affected the way small businesses operate and manage their resources. In particular, tax reforms introduced in 2005 were specifically targeted at supporting entrepreneurship.

The entrepreneur has been defined as someone who specialises in making judgmental decisions about the coordination of scarce resources. 1 J. B. Say, 2 one of the first writers on entrepreneurship, described an entrepreneur as the person who both owned and ran the business. Timmons 3 defined entrepreneurship as a human creative act involved in finding personal energy by initiating and building an enterprise or organisation, rather than by just watching, analysing or describing one. Other authors have emphasised the role of creativity and innovation as an intrinsic part of the entrepreneurial process. 4 Many policy questions are centred about entrepreneurship including those related to science and technology, sustainability, poverty, human capital, endogenous resources, employment, and taxation. Further, research priorities to date have focused on understanding and creating environments supportive of

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entrepreneurship in recognition of its potential to drive more positive outcomes on many of these policy issues.\textsuperscript{5}

For tax purposes the concept of an entrepreneur is considerably narrower and is defined according to annual turnover (as being below $75,000) and is unrelated to business structure.\textsuperscript{6} The persistent tension between tax reform and the small business sector has been the subject of considerable debate and research both in Australia and overseas,\textsuperscript{7} and in particular, the extent to which tax reforms have stifled entrepreneurship and imposed inefficient management practices, including regressive compliance costs, on small businesses.\textsuperscript{8}

There are six parts to this paper with the introduction being part one. Part II provides an explanation of the evolving definition of ‘small business’ in Australia and provides the background for the analysis that follows. This is followed by part III which is an overview of the tax reforms themselves with particular emphasis on those reforms from 1999 onwards that directly impact on small businesses. Part IV includes a chronological narrative discussion of various key research studies that have been conducted onto the impact of tax reform on small businesses in Australia. The paper then brings together the preceding parts and an analysis of the current state of play is presented in part V. The final part draws conclusions, makes recommendations for future policy and identifies areas where further research is needed.

By way of background, the Australian Bureau of Statistics has defined a ‘small business’ as one that employs less than 20 people for reporting purposes.\textsuperscript{9} On this basis, as at June 2004 it was estimated that there were 1.269 million small businesses operating in Australia, the majority of which had been in operation between 1 and 5 years (33 per cent) and were run by sole operators (72 per cent). In 2007 it was reported that there were around 1.84 million small businesses in Australia representing around 93 per cent of all businesses, and providing around 39 per cent of Australia’s value added and employing almost half of the non-agricultural workforce.\textsuperscript{10} Small businesses in Australia account for approximately 35 per cent of national economic activity.\textsuperscript{11}

However, the Australian Taxation Office (ATO), for administrative and management purposes, categorises businesses based on turnover. On this basis, there

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\begin{itemize}
  \item \textsuperscript{5} Acs \textit{et al} n 4.
  \item \textsuperscript{6} See s 61-505 Income Tax Assessment Act 1997.
  \item \textsuperscript{9} Australian Bureau of Statistics, 8127.0 ‘Characteristics of Small Business Australia’ (2004).
  \item \textsuperscript{10} The Board of Taxation, ‘Scoping Study of Small Business Tax Compliance Costs: A Report to the Treasurer’ (2007). The Report was released by the Treasurer on 12 November 2008.
  \item \textsuperscript{11} Australian Bureau of Statistics, 8155.0 ‘Australian Industry 2003-04’ (2006).
\end{itemize}
are around 1.9 million individuals and 600,000 companies operating as ‘micro’ businesses in Australia with an annual turnover below $2M. These micro businesses collectively employ 25 per cent of Australia’s workforce and pay about 11 per cent of the total taxes collected by the ATO.  

In spite of the variations apparent in the approach taken by government departments in describing small businesses, it is clear that in terms of economic contribution, revenue collections and employment, the small business sector (in its broader sense) plays a vital role in Australia. It follows that the sector could potentially have considerable influence on government, particularly in relation to obtaining concessions and incentives. However, the small business sector with its many diverse industry groups and lack of unity has tended not to realise its full potential as a lobby group compared to larger corporations (with peak bodies such as, for example, the Business Council of Australia).

II DEFINING A SMALL BUSINESS FOR THE PURPOSES OF TAX LAW

Until 1 July 2007, there has been no single definition of a small business for tax law purposes in Australia. For example, s152-15 of the *Income Tax Assessment Act 1997* in respect of tax on capital gains defined a small business in terms of its net assets not exceeding $5M. However, s960-335 of the same Act defined a ‘small business taxpayer’ as having an average annual turnover of less than $1M. From a tax law perspective, the definition of a small business is important as it normally determines how a taxpayer is to be treated, how often it is required to report, the accounting system to be used, and whether or not any tax concessions apply. For example, a small business with an annual turnover of less than $1M could account for Goods and Services Tax (GST) on a cash basis instead of an accrual basis and pay its quarterly tax instalments on the basis of GDP-adjusted notional tax. Further, there are exemptions on capital gains tax for eligible small businesses when owners retire or rollover capital gains made into the acquisition of another business.

The lack of alignment of the definition of a small business for tax law purposes was one aspect of concern raised by the Banks Taskforce in its report to the federal government on how to reduce the regulatory burden for Australian businesses. In response, changes were introduced to simplify the alignment of the various small business relief arrangements contained in the tax laws. From 1 July 2007 there is a common definition used for access to most small business concessions, namely the $2 million annual turnover, and the former Simplified Tax System (STS) was effectively abolished. While these changes were positive, it remains to be seen as to how widely (in terms of other federal departments and at the level of state government) the single tax definition of a small business will be adopted. However, while unaligned definitions for the purposes of tax law are problematic, there are

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16 Tax Laws Amendment (2006 Measures No. 7) Bill 2006 was first introduced to Parliament on 7 December 2006 and given assent on 12 April 2007, Act No. 55.
arguably other more significant tax issues that impact on small businesses and are consequences of the rapid and extensive tax reform that has been experienced in Australia.

Income tax makes up the largest component of the Australian federal government’s revenue base.\textsuperscript{19} The States and Territories raise a range of other taxes including payroll tax, stamp duties and land tax, with each having its own taxes, legislation and reporting requirements. Local governments (of which there are over 700 in Australia) principally rely on land rates and direct grants from their respective state governments.\textsuperscript{20} Governments at these various levels operate under a range of administrative structures that largely function in an independent manner (or at least appear to lack any co-ordination or inter communication) which has compliance cost implications for small businesses. This is in addition to the regressive compliance burden imposed on small businesses by taxation. This particular phenomenon is apparent worldwide and, in spite of attempts to address it by many governments, there appears to be little evidence of progress being made.\textsuperscript{21}

### III TAX REFORM

In terms of tax reform, few countries have experienced the rate of reform as has Australia, particularly since 2000, though it has been taking place almost unabated for more than 20 years. In the mid 1980s major administrative and technical reforms included the introduction of self assessment for all taxpayers and the introduction of a number of new regimes including Capital Gains Tax (CGT),\textsuperscript{22} Fringe Benefits Tax (FBT)\textsuperscript{23} and dividend imputation.\textsuperscript{24}

With the introduction of self assessment the burden of assessing annual tax returns shifted from the ATO to taxpayers thereby allowing the ATO to shift its resources to enforcement and other compliance related activities. Taxpayers sought greater certainty about their tax affairs and in response the ATO issued public and private rulings and governments passed more and more legislation. Apart from being voluminous, the legislation was widely regarded as extremely complex. In 1993 the Government announced that the tax legislation would be written in ‘plain English’ though this project was later abandoned\textsuperscript{25} (only one third complete) once the decision was made to introduce major reforms including a GST (to replace the wholesale sales tax) and the ill-fated STS for small business (and other related reforms in a package referred to as “A New Tax System” or ANTS) from 1 July 2000. As a result, in addition to the \textit{Income Tax Assessment Act 1936}, there is also the ‘plain English’

\textsuperscript{21} See n 7.
\textsuperscript{22} Introduced as Pt IIIA of the \textit{Income Tax Assessment Act 1936}.
\textsuperscript{23} See the \textit{Fringe Benefits Tax Assessment Act 1986}.
\textsuperscript{24} The imputation provisions were originally contained in Pt IIIAA of the \textit{Income Tax Assessment Act 1936} and have been replaced by the provisions contained in Pt 3-6 \textit{Income Tax Assessment Act 1997}.
Income Tax Assessment Act 1997, the outcome in fact being more legislation rather than less.\textsuperscript{26}

The introduction of GST from 1 July 2000 had enormous impact on small business practices. The GST applies at a flat rate of 10 per cent on the supply of most goods and services and is collected by the supplier who is required to be registered for GST purposes where the annual turnover exceeds $75,000 (assuming it is not a non-profit business).\textsuperscript{27} However, many smaller businesses chose to register in order to be able to claim input credits. Prior to the introduction of GST, there were some 79,000 businesses registered in Australia to collect Wholesale Sales Tax (WST) which the GST effectively replaced.\textsuperscript{28} In terms of the efficiency of revenue collections, the WST was far superior compared to the GST which had 2.3 million businesses registered as at 2 July 2004.\textsuperscript{29} Once registered, small businesses choose their accounting method for GST and this can be different to the method employed for income tax purposes. Many small businesses account for GST on a cash basis as this would generally have a positive impact on net cash flow and the reporting requirements are generally more manageable for the business owner.

Prior to the introduction of the GST many small businesses had cash flow problems and this was considered to be the main cause of business failure.\textsuperscript{30} Often this failure was due to lack of knowledge and/or poor planning on the part of small business owners who did not factor their tax obligations into the management of their cash flow and make adequate provisions to ensure liquidity. It was advocated that when a small business owner has a better understanding of their tax obligations and tax entitlements their cash flow can improve.\textsuperscript{31}

As part of the introduction of GST, a single identifier, an Australian Business Number (ABN) was introduced. In business-to-business transactions, the ABN of the supplier must be quoted otherwise the customer is required to withhold tax at the rate of 48.5 per cent from the payment. The ABN is used in dealings with all government departments and with customers. Small businesses have had to improve their record keeping practices to cope with these legislative reforms. Further, there have been numerous administrative reforms as the ATO has continually enhanced its provision of electronic services and small businesses have had to adapt accordingly. The ATO has provided software to help businesses manage their records and electronic portals for lodging returns and accessing information. However, it does appear that small businesses are struggling to meet the required standard of record keeping with the ATO reporting that 30 per cent of micro businesses failed in this regard.\textsuperscript{32}

It can be argued that the need for regular reporting of activity by small businesses (as required under the GST system) should lead to improved efficiency and profitability as managers have access to more timely information on their performance. However, this may not necessarily make small businesses better at

\textsuperscript{26} Note that while efforts have since been made to repeal inoperative provisions (leading to the repeal of more than 2,000 pages of legislation effective 14 September 2006), the continued existence of two Acts remains unaddressed.

\textsuperscript{27} The annual turnover threshold increased from $50,000 to $75,000 from 1 July 2007. See \textit{A New Tax System (Goods and Services Tax) Act 1999}.

\textsuperscript{28} \textit{Warren, N, Tax Facts Fiction and Reform} (2004).


managing liquidity. For the financial year ended 30 June 2006 the ATO\(^{33}\) reported that 67 per cent of the total tax debt outstanding was owed by micro businesses. It was expected that the extensive reporting required under the GST system would reduce opportunities for businesses to evade income tax. However, it is possible that the introduction of GST has increased the size of the cash economy rather than reduced it.\(^{34}\)

At the same time as introducing the GST, the STS for income tax purposes was introduced for small businesses. The STS initially required cash accounting and had different rules for calculating depreciation (including immediate write-offs for acquisitions costing less than $1,000) and requirements for accounting for trading stock. Eligibility to use the STS was based on annual average turnover and the intention was that it would offer reduced compliance costs to small businesses. However, at the end of the 2002 financial year only 4 per cent of eligible small businesses had elected to be taxed under the STS.\(^{35}\)

In response to ongoing criticisms, further reforms were introduced effective from 1 July 2005. These include relaxing the mandatory use of cash accounting for income tax purposes and the introduction of a 25 per cent Entrepreneur’s Tax Offset (ETO).\(^{36}\) The ETO is limited to taxpayers with an annual turnover of less than $75,000, with the full offset of 25 per cent applying only on turnovers of $50,000 or less. The offset is, in effect, recognition of and direct compensation for the regressive nature of compliance costs.\(^{37}\) However, in reality any compensation is limited to only very small businesses, or businesses that are in the ‘start up’ phase. It is not simple and it is difficult to see how it will help encourage entrepreneurship given the low threshold. Further, findings from studies into entrepreneurship have been inconclusive as to its drivers and impediments and this may be attributed to country-specific differences. The nature and direction of causal relationships between entrepreneurship and influences such as unemployment, poverty, and the regulatory burden of taxation are not yet clearly understood.\(^{38}\)

In contrast to the apparent merit in encouraging entrepreneurship, there are other reforms designed to protect the integrity of the tax system such as the non-commercial losses regime\(^{39}\) and the personal services income regime\(^{40}\) which seem to be at odds to this intent. The non-commercial losses regime basically denies an immediate deduction for a loss made by a small business where certain conditions are not satisfied (such as annual sales not exceeding $20,000). That is, where the business has not yet reached a ‘commercial’ level – which in effect would commonly be the start-up phase. The personal services regime effectively stops small business owners who operate from home from being taxed under any business structure other than a sole trader. Again, these regimes do not encourage entrepreneurship and it may well be that the tax system may not be the most appropriate mechanism for doing so. What they do serve to illustrate is the lack of clear and consistent policy in the Australian tax system, which can only add to its complexity.

\(^{33}\) See n 12.

\(^{34}\) To give some indication of the extent of the problem, the ATO (at n 12) reported that work to address the cash economy in 2006-07 resulted in $157M in total tax liability being raised.

\(^{35}\) The take up rate had increased to 25 per cent at the end of 2005. See n 18.

\(^{36}\) For more detail on the changes see Subdiv 152 Income Tax Assessment Act 1997 and, on the ETO specifically, see Subdiv 61-J of the same Act.


\(^{38}\) See n 5.


It is not surprising that Australian taxpayers are among the most agent dependent taxpayers in the world\textsuperscript{41} with some 93 per cent of business taxpayers using a tax agent to prepare and lodge their income tax returns.\textsuperscript{42} Small business owners do not have the time or understanding of the tax system to be able to manage their tax affairs. Compliance costs – not just monetary, but time, stress and opportunity costs – have been a critical issue for some time, but more so since the tax reforms on 2000. It has been widely recognised by both academic researchers\textsuperscript{43} and government\textsuperscript{44} that compliance costs are regressive, with the burden falling disproportionately on small businesses. While the emphasis in Australia to date has tended to on the measurement and financial impact of monetary and time costs, it is becoming increasingly apparent that all compliance costs have consequences for the survival and entrepreneurship capability of small business. Further, to some extent the emphasis on measurement has detracted from the underlying need to understand the impact of these costs and of tax reform more generally on small businesses.

In the past there have been comprehensive reviews\textsuperscript{45} that tended to be specifically targeted at increasing the efficiency of small business and reducing (or compensating for) compliance costs, though their recommendations have not always been accepted or adopted, nor is it clear that efficiency has been increased when changes have been made. Given the outcomes of these reviews and the fact that tax reform has continued, it can readily be seen why the need to address the compliance costs for small business still remains on the political agenda. For example, the Federal Treasurer requested the Board of Taxation\textsuperscript{46} in 2004 to undertake a post-implementation review of the effectiveness of the small business CGT concessions and in 2006 to undertake a scoping study of small business compliance costs. Thirty nine recommendations (both legislative and administrative) were forthcoming as a result of the first review and these were (with one exception) accepted by the government and the ATO.

The final report of the second review (i.e. the scoping study into small business compliance costs) has only been recently released. Its focus was on understanding the management practices of ‘micro’ businesses and how they coped with regulatory compliance (not only tax and not only federal government requirements) and was based on a qualitative research design. This review found that the small business sector is extremely diverse and that their compliance costs are influenced by size, turnover and structure of their businesses. Further, tax compliance activities may

\textsuperscript{42} McKerchar, M, ‘The impact of income tax complexity upon practitioners in Australia’ (2005) 20 \textit{Australian Tax Forum} 529.
\textsuperscript{45} The Taxation Review Committee (Asprey Committee) commenced in 1972; Small Business Regulation Taskforce (Bell Taskforce) commenced in 1996 and the Review of Business Taxation (Ralph Review) commenced in 1998.
\textsuperscript{46} The Board of Taxation was established in 2000 following a recommendation of the Ralph Review (see note 45). The Board is an independent body that advises the government on the formulation and development of tax policy.
provide benefits to business by imposing a discipline that allows them to better monitor and understand their business dealings and cash flows. These more recent studies provide useful insights into both the drivers and consequences of compliance costs for small business which, in turn, should assist governments in fostering more effective management practices in the small business sector and thereby facilitate greater entrepreneurship.

IV RESEARCH

Early research into the impact of tax reform on small businesses in Australia focused on the measurement and incidence of compliance costs and tended to be quantitative in nature. The works of Pope et al and of Evans et al were groundbreaking at the time and found that compliance costs were very high, though the ATO was critical of the methodology used (particularly in respect of the estimation and valuation of taxpayers’ time costs). In many respects the criticisms (which focused on measurement) were unfortunate in that they drew attention away from the extent and significance of the issue of the costs themselves. The valuation of owners’ time spent on compliance activities has been contentious given its subjectivity.

Wallschutzky and Gibson undertook the first qualitative study in Australia on small business compliance costs, basing their work on Yin’s case study strategy of inquiry. Wallschutzky and Gibson concluded that, based on their research (using diaries and interviews over a 12 month period), small businesses found that tax compliance was not difficult nor time consuming and that the tax compliance issue was overstated. One of the common criticisms of their work was the limited number of cases (12), their representativeness, and the extent to which broader analytical generalisations could be made.

A later large scale study was commissioned by the ATO and conducted by Evans et al in 1995-1996. This study was quantitative in nature and included a survey of 10,000 taxpayers. It was found that overall, compliance costs were significant and for business taxpayers, represented (at the time) 9.4 per cent of all federal tax revenue and 1.02 per cent of GDP.

It is important to bear in mind that these studies preceded the introduction of the GST and other major reforms that accompanied it from 1 July 2000. Subsequent research needed to clearly identify those compliance costs that were transitional and those that were ongoing in order to gauge the impact of the reforms. Rametse and Pope surveyed 868 small businesses in Western Australia in September/October 2000, just after the introduction of the GST. They found that the average gross start-up cost was $5,006 (excluding time costs) and $7,626 (including time costs). The average time spent per business in preparing to comply with the GST requirements

48 See Evans et al at n 43.
50 Yin, R, Case Study Research: Design and Methods (2nd edn 1989).
51 See n 49.
52 See n 43.
was 131 hours. The research also confirmed that the GST start up costs were regressive.

Tran Nam and Glover\textsuperscript{54} undertook a mixed method approach (survey and semi-structured interviews) to estimate the transitional compliance costs of the GST. They found that small businesses were considerably stressed during the transitional period, but that owners did report an improvement in stress levels in the immediate following year which was attributed to them having ‘learnt by doing’. Tran Nam and Glover found that the mean gross transitional cost was $7,700, a similar result to Rametse and Pope and well short of the $200 compensation the Federal Government gave each business at the time. However, based on their interviews, Tran Nam and Glover found that time was the main transitional compliance cost issue for small businesses.

Drever and Hartcher\textsuperscript{55} studied the impact of the GST on small businesses 12 months after its implementation with an emphasis on the impact on management practices. Using a large scale survey\textsuperscript{56} of both manufacturing and service industries, they found that the GST had had a compounding effect on cash management practices with respondents typically reporting their concerns about the control of creditors and debtors in the following manner: ‘Payments of our invoices are a lot slower’ and ‘Debtors are slower to pay their accounts’. Comments in relation to paying on time included: ‘Most businesses are reluctant to pay on time which has a flow on of us not being able to meet our creditor payments on time’ and ‘Payments of our invoices are a lot slower. We are slower paying’.

The timing of receipts and payments is clearly an issue in terms of managing cash flow. However, where businesses chose to account for GST on a cash accounting basis in order to better manage cash flow and minimise compliance costs, they may have jeopardised, to some extent, their ability to manage their debtors. This is a cause for concern in that the management of accounts receivable is paramount to the survival and success of every business.\textsuperscript{57} There are numerous examples in the media of the seriousness of this threat to liquidity, from the level of small business tax debt as discussed previously, to the record rise in the number of small business bankruptcies in Australia which doubled from 2,088 in 1988-1989 to 3,899 in 1999-2000, having reached a peak of 5,905 in 1998-1999.\textsuperscript{58}

Drever and Hartcher\textsuperscript{59} found that cash flow management was a problem experienced by small businesses. Comments in this regard included: ‘Business in this area fluctuates dramatically and if cash flow decreases the quarterly GST, PAYG and superannuation and personal tax payments are quite difficult to meet – sometimes it’s not feasible to put enough in a separate account and still pay creditors on time’. There was evidence that, with the introduction of the GST, having to report business activity every three months provided the small business owner with a better idea of how the business was operating particularly in respect of its cash flow management. For example, it was reported that ‘tax and GST is paid together with the one account,'


\textsuperscript{56} The sample size of 3,658 was approximately 28% of the total population for the region drawn from the North Coast of NSW. After excluding for out of frames, a response rate of 12.2% resulted.

\textsuperscript{57} See n 8.

\textsuperscript{58} See n 30.

\textsuperscript{59} See n 55.
and there is no large sum at end of year. This allows us to budget for our personal expenditure.’

Drever and Hartcher, found that small businesses reported that their record keeping practices had improved with the introduction of the GST. This was evidenced by comments including ‘GST is a great tax! It teaches you to manage the cash or you’ll have no cash’; ‘More diligent with account keeping’ and ‘Far more time is spent updating records, reconciling all records. Instead of doing annual tax returns we had to employ an extra person, part-time to cope with extra work-load. The additional time spent has caused stress on business and family’.

Drever and DeVries, found that Australian entrepreneurs expected a high standard of professional advice on taxation matters, and more consistently than did their counterparts in New Zealand. In particular, Australian entrepreneurs required accurate and useful advice on taxation and on how they might more efficiently manage their businesses. They were concerned with strategies that would allow them to minimise overheads. Where the business employed an accountant, there was the expectation that the accountant would participate in the management of the business, not be just the bookkeeper. Some felt that their accountants were not aggressive enough in advising the partners on the progress of the business. New Zealand entrepreneurs were divided about the use of advisors. Many used a variety of advisors including accountants, bankers and mentors; but as one respondent stated ‘Didn’t tend to use advisors much – I probably didn’t really appreciate the fact that they could be useful.’

Drever and DeVries also found that some Australian entrepreneurs expressed concern about their accountants and saw them as particularly useful for tax advice, however, were extremely critical about their general apparent lack of interest in the business generally. Some also expressed concern about the conservative nature of the advice given by their solicitors.

In spite of the recognition of the benefits and the necessity for small businesses to adopt sound management practices, it appears that there is still considerable scope for improvement. Part of the challenge is for small businesses to manage their limited resources, be they time, money or staff, more effectively to ensure business survival, and at the same time, be entrepreneurial in their outlook and practices. It appears that small businesses are finding it very difficult to make real progress in entrepreneurship and longer-term vision and that further government intervention may be necessary. Given their fundamental importance to the country as a whole, policymakers and administrators have to give immediate consideration to developing a sound understanding of the sector and then focus on the implementation of appropriate strategies to allow entrepreneurship to develop and thrive.

V ANALYSIS

There are three key reasons why the needs of small businesses in Australia have not been met by successive federal governments and their tax reforms. Firstly, the sector (which comprises almost all of Australian businesses) is not homogenous and insufficient attention is given to the consequences of reforms on the various subsets of

60 Ibid.
62 See n 61.
‘small business’ (whether they be categorised by age, industry type, location or other dimensions). This problem is exacerbated, at least in respect of tax reforms, by an apparent lack of understanding of how small businesses operate and the likely effect of reforms on these practices. For example, the initial requirement of STS to use cash accounting was at odds with good management practices for businesses with debtors and creditors. Similarly, the ability to account for GST on a cash basis and income tax on an accruals basis requires a more complex (and costly) accounting system than many small business operators are able to manage (or need) themselves.

Secondly, the underlying tax policies are unclear, at times conflicting, and subject to ongoing change. For example, on one hand the tax system appears to encourage entrepreneurship by the means of a tax offset, but other regimes (such as non-commercial losses and personal services income, both post 2000) already exist that appear to be in direct conflict with the intent of the offset. Further, the restrictions on turnover and the rate of offset appear to be set very low and as such may not offer any real encouragement to the budding entrepreneur.

An offset to promote entrepreneurship appears to have merit, but it would need to be more widely available and at a higher rate if real benefits are to accrue. It may be that the tax system is not the appropriate mechanism for fostering entrepreneurship and that other forms of direct incentives based on different factors (such as length of time in business, industry type or the number of employees) may be more appropriate than turnover.

Lack of clear and consistent tax policy has led to ad hoc changes and the need for remedial legislation and administrative intervention. The rate of change has made it very difficult for small business taxpayers to really benefit from ‘learning by doing’ when time is a scarce commodity, and expensive if compliance obligations are to be met.

This leads back to the fundamental question of the clarity of policy intent – what is the purpose of the offset? Is it to foster entrepreneurship or is it to compensate small businesses for the regressive nature of compliance costs? If it is the former, then the point has already been made that the offset appears to miss this mark. If it is the latter, then a direct compensatory payment may be more effective than an offset based simply on turnover. However, given that research in Australia to date indicates that time is the most costly aspect of compliance, then it may be that neither a direct monetary compensation nor a tax saving could prove to be effective.

There is a danger that, similar to the debate on the method of measuring compliance costs that delayed any progress on addressing the problem of how to reduce them, the focus on compensation for compliance costs deflects attention from the third and most fundamental problem, that is, not enough is being done by governments to assist small businesses in developing better management practices and to prosper. There have been reviews and much rhetoric on reducing regulation and red tape, but given the structure and nature of government in Australia, it is difficult to hold wholly any one government responsible for the problem. The reduction and harmonisation of regulatory requirements will require serious dialogue, strategies and vision between

64 Given the lack of agreement in the extant literature (see for example Evans et al at note 43) on how compliance costs should be measured, it is difficult to determine how much compensation, by way of the ETO, is necessary.
all levels of government if any real improvements are to be made. But this is only one aspect where assistance by government could develop better strategies to benefit small business and allow them to be more competitive in the global marketplace. There is considerable scope for clear and well-developed government policies directed at encouraging small businesses to be more entrepreneurial, more competitive internationally, and to be better managers of their records, their business activities, and their cash and other liquid assets.

VI CONCLUSION

Australian tax laws are complex, as they are in many other regimes. While complex tax laws affect all taxpayers, it is clear that small business taxpayers, which represent a large and vital sector of the Australian economy, bear more than their share of the burden of compliance costs. While much attention has been given by government, policy makers, administrators and researchers to identifying and measuring the costs of compliance and their incidence, there remains a great deal of work to be done to understand these costs, their effects on business practices and entrepreneurship, and how these costs be reduced and/or greater efficiencies and gains be achieved. Valuable lessons can be learnt from the entrepreneur as to what is best and most efficient and effective practice in preparing and utilising reports prepared for tax purposes. The three level structure of government and its lack of co-ordination, communication and commitment is a key reason for the failure to address the level of regulation which applies to the small business sector in Australia. Whilst the focus of the paper has been on federal taxation, there are many other aspects of regulation – including superannuation, workers compensation and occupational health and safety – that impose enormous burdens on small business and which undergo numerous changes with scant consideration of how these changes will impact on small businesses.

There is a need for governments, policy makers, administrators and researchers to develop a better understanding of small businesses and their management practices. Policy intent needs to be articulated more clearly and with consistency, and changes (where necessary) need to be made in the context of a more strategic vision for the small business sector and an overriding goal to make it as simple as possible for small business to be better managed and to thrive. Further research should centre on how the entrepreneur understand the income tax and goods and services returns and what impact it has had on their businesses.

Further research is necessary in understanding the Australian small business sector as a whole, how they conduct their businesses and how their tax compliance obligations can be better utilised to further stimulate entrepreneurship. There is also a need for policymakers and other stakeholders to have a greater understanding of the needs, practices and diversity of the small business sector. This requires the adoption of a much wider policy perspective (i.e. not just tax in isolation) so that integration is achieved and consequences foreseen and taken into account. With this greater understanding more informed and effective policies can then be developed and the longer term sustainability of the sector enhanced. Finally, as part of the need for integrated government policies, it will be essential to have further research conducted on the drivers of entrepreneurship (such as the effectiveness of the tax offset) and how it can be more effectively encouraged by engaging accountants to provide proactive strategies for their respective challenges for the small business sector.