INSTITUTE OF PUBLIC ACCOUNTANTS

PRE-BUDGET SUBMISSION 2023-24

January 2023

Introduction

The Institute of Public Accountants (IPA) Group welcomes the opportunity to present our pre-Budget submission for the 2023-24 financial year. We look forward to working with the Government on its economic agenda set against the challenges of an uncertain domestic and international environment.

The IPA is one of the three professional accounting bodies in Australia, representing over 50,000 members and students in Australia and in over 100 countries. The IPA takes an active role in the promotion of policies to assist the small business and SME sectors, reflecting the fact that approximately three-quarters of our members either work in or advise these sectors. The IPA pursues fundamental reforms aimed at boosting productivity growth; and in easing the disproportionate regulatory compliance burden on small business.

In 2015, the IPA Deakin SME Research Centre launched the first Australian Small Business White Paper which contained recommendations to boost productivity growth through increasing small business and SME innovation, competition, and participation. Further white papers followed in 2018 and 2021, with the third one (benefitting from access to BLADE) taking a deeper dive into innovation policy. All white papers have benefited from extensive stakeholder consultation.

Extracts and recommendations from the white papers are included in this pre-Budget submission. They can be accessed at, white papers.

The main themes and recommendations from the white papers include:

- **Productivity of small business** – improving the technical efficiency of Australian businesses.
- **Regulatory overload** – adopting a risk adjusted approach, whilst also relying on regtech solutions, which can shift the conversation from the burden and amount of regulation to the way we deal with it.
- **Taxation of small business and SMEs** – what is their overall contribution to tax collection and how to optimise the tax system, including changes to the tax mix.
- **Workplace relations** – ensuring we have policies which facilitate growth-based small businesses.
- **Net employment dynamics** – what is the role of small business and SMEs in creating employment and how to improve it.
- **Innovation policy** – incremental innovation can be achieved across the economy with the message that innovation creates jobs.
- **Trade policy and internationalisation** – the performance of small business and SMEs needs to improve so a more meaningful contribution can be made to the economy. Trade diversification now and post-COVID will be essential.

The IPA emphasises that major reform cannot always be achieved in a short timeframe, and we urge the Government to take a longer-term view based on a clear, determined and well communicated path for the Australian economy and Australian society.

In particular, the IPA is keen to ensure that bold tax reform becomes a priority for the Government and the IPA will continue to voice its disappointment with the stalled tax reform process. A piecemeal approach is sub-optimal and may even prove harmful to long-term reform.

In addition, the IPA urges the Government to commit to a progressive innovation policy despite setbacks by previous governments with communicating the benefits. In this regard, we emphasise the findings and recommendations of the white paper released by the IPA Deakin SME Research Centre in July 2021, *Post Covid Policy Options to Enhance Australia's Innovation Capabilities*.

We note that our focus is shared by the findings of the Productivity Commission in its *5 Year Productivity Inquiry: Innovation for the 98%*, released in September 2022, as part of the Productivity Inquiry, with the final report to be delivered in February 2023. We note the words of the Productivity Commission and its Deputy Chair Dr Alex Robson:

With only between one and two per cent of Australian businesses producing new to the world innovation, consideration must be given to how to help the other 98 per cent adopt and adapt existing technologies and practices to improve performance and productivity.

Policy has traditionally been focused on cutting edge invention, but there are likely to be bigger gains in encouraging everyday, incremental innovation across the vast majority of Australian businesses.

There are worrying signs that the principal vehicles for acquiring and transferring knowledge – what we refer to as diffusion – have slowed or stalled. While previously we could have relied on labour mobility and investment in machinery, equipment and intangible capital to spread ideas, these have all been either stagnating or declining.

Diffusion has the potential to lift the performance of over a million businesses.

The drivers for diffusion are less about specific government funding programs than about getting broad market settings right to create a vibrant business environment. This includes a more open trade and investment regime and recognition of the value of skilled migration as a source of new ideas.

At the individual business level, things like managers' ability to exploit existing innovation, increasing knowledge through recruitment decisions, leveraging industry bodies to connect firms with information about new and better ways of operating, and linkages with universities beyond direct commercialisation can all drive productivity and improve performance.

We would be pleased to discuss our recommendations in more detail or to provide further information. Please contact Vicki Stylianou (vicki.stylianou@publicaccountants.org.au) in the first instance.

Yours faithfully

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Small Business: Big Vision recommendations

Productivity matters because, simply put, productivity growth is the primary determinant of income growth. As long as productivity remains stagnant, Australia faces a significant challenge in maintaining the nation's living standards.

Given the significance of the small business sector, it has the potential to positively influence productivity growth. However, despite the more recent impact of COVID-19, Australian small businesses still operate in an increasingly complex global environment of increased interconnectedness, interdependence, uncertainty, and change. For this reason, and others, the sector requires support to become more innovative and efficient, to employ more people and to export more.

The IPA Deakin SME Research Centre believes government has an important role to play in positively influencing productivity growth, with measures such as:

- Enabling and promoting access to affordable finance to improve the longevity of small businesses
- Facilitating education and skills development for small business owner-managers
- Updating regulatory settings over time, so as not to impede, and to encourage, private sector investment
- Resisting protectionism and facilitating increased access for small businesses to international markets
- Fine-tuning innovation policy to reward collaborative research, support innovation diffusion and expedite the commercialisation of innovative ideas, especially in the technology space
- Reforming the taxation system to increase incentives and decrease disincentives to the establishment and growth of innovative small businesses
- Undertaking workplace relations reform to ensure the framework delivers consistency and stability to small business owner-managers
- Establishing a central, 'one-stop-shop' government agency for small businesses, similar to the US Small Business Administration.

Regulatory burden overload

The IPA-Deakin SME Research Centre continues to be concerned about the impact of regulations developed by lawmakers in Australia, and in offshore jurisdictions, which can impair the ability of small business owners to focus on growing their businesses.

Reducing the overall regulatory burden will relieve small business owners of onerous compliance tasks and reduce the cost of doing business. Regulatory imposts remain one of the key problems cited by small business (ie as time consuming and unnecessary requirements that impair their ability to spend more time on innovation and on growing their enterprises).

1. Recommendations

- The Government should emphasise the need for 'risk-based' regulation, so individuals and entities that are at a 'low risk' of non-compliance are not subjected to inappropriate and unnecessary regulatory scrutiny. The EU style 'small first' approach should be adopted.

- The Government should contribute to and be guided by the work of the OECD in enhancing global awareness of and applying good regulatory practice.
- The Government should conduct meaningful and genuine periodic reviews of regulatory agencies/bodies and statutory boards to ensure that public interest is well served. Despite numerous reviews, taskforces and so on, there is only minor improvement, if any, in the overall regulatory burden placed on small business and all business in general.
- The Government should ensure that the Office of Impact Analysis is adequately resourced to undertake genuine evidence-based cost-benefit analysis, and that its work should not be impacted by political imperative.
- The Government should ensure that all company financial records are available free-of-charge to the public. We acknowledge and welcome the work being undertaken to modernize business registers and communication.
- The Government should consider the role of regtech (technology-based solutions applied to regulatory compliance) and facilitate the introduction, development, and application of regtech solutions (especially by small business) as a means of easing the regulatory burden.

Taxation reform – time to act

Reform has stalled in Australia, in part because most tax discussions have been the subject of political trench warfare. Partisan arguments over reforms will usually result in no change unless a government has the necessary numbers in both houses of the Federal Parliament to successfully shepherd through reform without the need for unnecessary compromise.

Over the years, successive governments had begun a process of dialogue on how to create a tax system that supports higher economic growth and living standards, improves international competitiveness and adjusts to a changing economy. In 2010 we had the release of the Henry Review into taxation followed in 2015 by the Rethink paper on tax reform. Despite these efforts, we have not seen movement on fundamental tax reform, instead we have experienced a piecemeal approach to tax policy. Simply tinkering at the edges to create 'stop gap' solutions will not address the need for fundamental reform. The tax system was already failing to address a changing pre-COVID-19 economy and was seen as holding Australia back in fulfilling its economic potential. It represents one of many important levers that the Government has at its disposal to reinvigorate a much-needed growth agenda.

For a long time, tax reform has been stated as a key part of successive government’s policy agenda to build jobs, growth, and opportunity, yet there has been little progress to achieve these stated aims. There is an even greater need to reform our tax system to manage long-term fiscal sustainability and our long-term debt position. Worsening global economic conditions, high inflation, interest rate rises and structural expenditure risks, such as ageing, and climate change will present fiscal challenges in the years ahead.

Pre-COVID we were in a relatively good position fiscally as compared to many OECD countries, with relatively low government debt and a Commonwealth budget almost back in surplus. As a result of the Government COVID response package put in place to support a slowing economy, our debt level has increased in percentage terms much more than most OECD countries. Australia is the only member of the G20 to have increased debt by more than 200% over a period that includes the dot.com recession, the global financial crisis (GFC) and now the coronavirus recession. With a substantial increase in debt and forecast deficits for the next ten years, our tax system is ill-equipped to manage the economic challenges ahead given the reliance on personal and company tax at the Commonwealth level and property transactions at the State level. Australia has a high reliance on income taxes, including company income tax. Around 60% of the Commonwealth's tax receipts come through personal and company income taxes, nearly twice the OECD average. Growth in personal tax revenue is driven mainly from bracket creep. High reliance on personal income tax can introduce risks to the budget. Analysis from Treasury shows the average personal income tax rate will rise from about 23% this year to almost 27% over the next decade, even if the much-debated stage three personal income tax cuts take effect from 2024-25. This represents a disproportionate burden on personal taxpayers in the years ahead unless corrective action is taken, and the tax base is broadened.

Australia's experience from the GFC suggests that it will take a long time for corporate taxes to recover from the COVID-19 downturn as company losses are carried forward and tax incentives remain in place. This puts additional pressure on personal income taxes to carry the load. The recent spike in prices in key export commodities has provided a temporary lift in company receipts from mining related activities. This situation will reverse at some point as commodity prices return to normal levels.

The base and rate of our GST will also hamper the Government's ability to make up for any lost revenue from direct taxes on personal and company taxes. The percentage of consumption on which GST is payable now stands at around 47% due to exemptions on food, education, and health. GST exemptions now disproportionately benefit higher income households. To enable governments to support the economy back to health requires rebuilding the tax base with efficient growth supporting taxes.

The COVID related slowdown has undermined the ability of governments to raise revenue given the disruption to business and personal incomes and changed consumption and saving behaviour. With additional government expenditure to support the economy, governments will be challenged to reinvent their tax systems without stifling economic growth and will need comprehensive tax reform as part of the forward solution.

The COVID pandemic has now exposed an ill-equipped tax system to support the recovery process. An effective taxation system should be premised on achieving:

• fairness – or 'equity' as between taxpayers, with respect to ensuring that taxpayers in similar positions bear tax at the same level, but also that tax is borne at a level commensurate with the taxpayer's ability to pay;

• efficiency – that is, the system should not encourage the distortion of economic decisions; and

• simplicity – the system should be relatively easy to understand and place a low administrative burden on taxpayers.

Australia's current taxation regime has arguably moved away from these ideals and can be described as inefficient, technically complex, and often distortive. A tax system exhibiting the above features usually results in high levels of voluntary compliance. Australia relies on maintaining high levels of voluntary compliance which could wane over time if our tax system is not perceived as "fair".

Different layers of Federal and State taxes also increase complexity. We are riddled with a vast range of inefficient taxes imposed by the State Governments (and each subject to its own legislative regime and rules). Taxes such as stamp duty and payroll tax are distortive and will often discourage business transactions and wage growth respectively. It has been well documented that 90% of total tax revenue collected by Australian Governments, was derived from only 10 of the 125 taxes paid by Australians each year. Conversely, 10% of tax revenue was contributed by the remaining 115 taxes.

Sensible, well considered, wholesale structural reform of Australia's taxation system is likely to provide an efficient way to manage Australia's road to fiscal recovery in a post COVID world. The need to rebuild our own economy and the unprecedented expenditure used to fund Government stimulus packages requires a sustainable tax base. This need pre-existed the COVID-19 crisis, so it's an opportune time to be bold and unshackle the economy from the restraints imposed by our current tax settings.

The OECD has repeatedly warned Australia that it faces a downgraded outlook for living standards over the next 40 years, without structural reforms to arrest the decline in productivity and deal with budget pressures from an ageing population. Part of the structural reforms recommended by the OECD include an overhaul of the GST, lower tax concessions and the need to develop a clear plan to reduce debt coming out of the COVID-19 crisis.

Australia is not alone in expecting a fall in projected living standards, with most major advanced economies coming under pressure from changing population demographics and poor productivity outcomes.

In addition to the IPA Deakin SME Research Centre White Paper recommendations (below) there are several key areas within the existing tax system that require immediate attention, including the Superannuation Guarantee (SG), Division 7A, Non-Arm's Length Income rules, Fringe Benefits Tax (FBT) regime, small business Capital Gains Tax (CGT), Small Business Tax Offset, and the recommendations from the Black Economy Taskforce.

This is not an exhaustive list and is not in order of priority.

Superannuation Guarantee regime

The penalties imposed on employers for late or underpayment of the SG contributions under the *Superannuation Guarantee (Administration) Act 1992* (SGAA 1992) are considered too harsh and disincentivise employers to come forward and disclose non-compliance. If you do not pay an employee's minimum SG amount on time and to the right fund, you must pay the SG charge (SGC) and lodge an SGC statement to the ATO. The SGC is more than the superannuation you would have otherwise paid to the employee's fund and is not tax deductible.

As the law currently stands, when an employer fails to make SG contributions on behalf of an employee, they are liable for the SGC which is calculated as follows:

- the SG shortfall, calculated on salary and wages (including any overtime);
- nominal interest of 10% per annum (accrues from the start of the relevant quarter which means that while the shortfall doesn't arise until 28 days after the end of the relevant quarter, interest accrues from the first day of the relevant quarter, for example, for the June quarter, an SGC shortfall arises after 28 July, while interest on the shortfall amount is calculated from 1 April); and
- an administration fee of $20 per employee per quarter.

Employers may also be liable for:

- A penalty of up to 200% of the SGC amount under Part 7 of the SGAA;
- A penalty of up to 100% under the Taxation Administration Act 1953 (TAA);
- A choice of fund penalty up to $500 per quarter per employee; and
- An amount equal to the SGC personally if the Commissioner of Taxation issues a director penalty notice.

These penalties can apply irrespective of whether the failure to make SG contributions was an inadvertent mistake or misunderstanding in applying complex legislative provisions (eg in determining whether a contractor is engaged under a contract that is principally for their labour, such that SG contributions are required to be made on behalf of that contractor), or deliberate avoidance (although the Commissioner may remit certain applicable penalties where the employer is genuinely attempting to comply with their SG obligations, and otherwise has a good compliance history). PS LA 2021/3 provides guidance on factors the Commissioner will consider in reducing Part 7 penalties.

2. Recommendations

Many employers particularly smaller ones are disincentivized in coming forward and subjecting themselves to harsh penalties for falling behind with their payments but who would otherwise be willing to do so if the consequences were not so harsh. We recommend the following:

1. Reducing the draconian Part 7 200% penalties applied for non-payment or late payment of SG contributions as they are unjustifiably harsh particularly for small businesses; and particularly given improvements to the information gathering powers of the ATO since the introduction of Single Touch Payroll. We have pay-event reporting of SG accruals, and event-based reporting of contribution payments from funds regulated by the Australian Prudential Regulation Authority. This information provides the ATO with end-to-end visibility of where an employer has not met their SG obligations for their employees.
2. That the nominal interest imposed under section 31 of the SGAA 1992 should apply only for the period that an SG contribution was not made to the fund. It should not be linked to the date on which the SG charge 'would be payable under [the] Act'.
3. Further, the Commissioner should be provided with discretion to remit the nominal interest or administration component in appropriate circumstances. The current inability for the Commissioner to remit either of these two components is unfairly restrictive.
4. Reintroduce another amnesty disclosure to make good historical non-compliance. *The Treasury Laws Amendment (Recovering Unpaid Superannuation) Act 2020* introduced a one-off amnesty for employers who voluntarily disclosed SGC liabilities for quarters from 1 July 1992 to 31 March 2018 (known as historical quarters). If an eligible employer lodged SG statements for historical quarters within the amnesty period (from 24 May 2018 to 7 September 2020), no Part 7 penalty was imposed on the SGC assessments. Employers who were unable to make necessary disclosures during 2020 (amnesty coincided with COVID-19 pandemic) be allowed another opportunity to make good historical non-compliance.

Non-Arm's Length Income

There is an urgent need to amend the existing Non-arm's Length Income (NALI) rules (S295-550 of ITAA 1997). If the current rules remain intact, immaterial breaches could trigger a punitive tax rate on all future income of a superannuation fund, which is an absurd situation, impacting on the superannuation balances of members. The impacts are broad, affecting all superannuation funds, and not just SMSFs. The tax impact on superannuation funds and individuals' balances cannot be understated. The resulting tax liability for income in superannuation funds will be three times higher than the standard 15% rate.

The IPA has no issues in supporting the original policy intent. The ATO's recent interpretative guidance highlights the broad application of these rules, arguably beyond the original policy intent, which is at the core of our concerns. Given the ATO's administrative stance on its interpretation of the rules, a law change is required to alter the scope and impacts, whilst still preserving the original policy intent. There still needs to be a disincentive and a consequence for targeted mischiefs, rather than potentially affecting all income of the fund. The fact that the rules operate automatically, also goes against existing anti-avoidance provisions in our tax legislation which requires the Commissioner to make a determination for the anti-avoidance to apply.

On 10 June 2022 the ATO extended its transitional compliance approach for NALI provisions by for non-arm's length expenses (NALE) of a general nature by another 12 months to 30 June 2023.The compliance relief was originally due to expire on 30 June 2022 but the ATO issued an update to its Practical Compliance Guideline (PCG) 2020/5, which deals with the ATO's compliance approach in the application of the NALI provisions to NALE.

PCG 2020/5 therefore provides relief for financial years 2018/19 to 2022/23 whereby the ATO will not allocate compliance resources to determine whether the NALI provisions apply to all the income of the fund where the fund incurs NALE of a general nature on or before 30 June 2023.

Whilst the extension is welcome, it is important to note that PCG 2020/5 has a very limited application as it only refers to expenditure of a general nature incurred by the fund that has a sufficient nexus to all of the income of the fund. It does not apply where the fund incurred NALE that is directly linked to a particular investment or asset by the fund.

3. Recommendations

We appreciate the need to ensure that the superannuation system is not improperly used by individuals and groups to artificially minimise or reduce tax. However, correcting this behaviour should not come at the cost of inequitable treatment for all Australians. We therefore request an urgent announcement regarding the rules being rewritten so that we can work with the Government and Treasury on an appropriately targeted and measured solution. To this end there should also be provision for rectification of any breaches and a penalty regime that aligns with the tax consequences of not conducting the transaction at market or on an arm's length basis. On 25 January Treasury released a consultation paper exploring potential policy changes to the NALI provisions where they relate to general expenses.

These potential amendments are intended to ensure the rules continue to operate in line with their original policy intent and provide a greater level of certainty to trustees ahead of the expiry of the transitional compliance approach (PCG 2020/5) on 30 June 2023. We welcome this announcement. The proposed option of including an amount equal to five times the difference between an arm's-length expense and the expense that was incurred could still give rise to disproportionate outcomes particularly if the breach was small and inadvertent. This is particularly so if the SMSFs had no recourse to address the breach. We will respond to the consultation paper specifically in due course as part of the consultation process.

Division 7A: reduce uncertainty around future changes

The Government has acknowledged that Division 7A needs urgent reform. The Government announced in the 2017 Federal Budget that amendments would be made to Division 7A incorporating recommendations from the 2014 Board of Taxation's final report on the 'Post Implementation Review of Division 7A of Part III of the Income Tax Assessment Act 1936' (BOT report). The start date was to have been 1 July 2018, although the Government deferred the start date again to 1 July 2020. The latest update from the Government on Division 7A was on 30 June 2020 announcing that the start date on amendments will now apply from income years commencing on or after the date of Royal Assent of the enabling legislation.

Treasury released a Consultation Paper in September 2018, to seek stakeholder views on proposed amendments to Division 7A. The consultation paper draws on but includes significant departures from the recommendations in the BOT report. If legislated in its current form, there is potential for a substantial increase in compliance costs and tax payable by business entities using trusts for business purposes.

Some key elements of the proposed new regime outlined in the Consultation Paper include:

- New "simplified" single ten-year loans with interest charged at the Reserve Bank overdraft rate for small business (which is much higher than the current Division 7A rate).
- Not adopting the amortisation model with principal repayments at the 3, 5, 8 and 10 years as recommended by the BOT report and instead requiring annual interest and principal payments.
- Regardless of when a repayment occurs during the income year, interest will be for the full year.
- The transitioning of both 7- and 25-year loans under Division 7A into the new regime. The BOT report had recommended grandfathering (preserving) 25-year loans under the existing arrangements.
- Both existing 7- and 25-year loans will be subject to the new higher overdraft interest rate.
- Existing 7-year loans will keep their current outstanding term when transitioned into the new regime, but existing 25-year loans must be put on new 10-year complying loan arrangements prior to the lodgment day of the company tax return for the 2021 income year.
- The removal of the concept of distributable surplus such that there is no limit to the amount that may trigger a deemed dividend under Division 7A.
- The extension of the review period for Division 7A to 14 years after the end of the income year in which the loan, payment, or debt forgiveness are triggered, or would have triggered, a deemed dividend.

Both pre-4 December 1997 loans (with the benefit of a two-year grace period) and Unpaid Present Entitlements (UPEs) arising on or after 16 December 2009 must be put on new complying ten-year loans. The proposal does not specifically address pre-16 December 2009 UPEs.

The BOT report's recommendation for a once-and-for-all election to exclude loans from companies (including UPEs owing to companies) from the operation of Division 7A (the 'business income election') is not included in the proposed amendments. The Consultation Paper has taken a selective approach, removing the ability to choose to be excluded from the Division 7A regime, while introducing many of the integrity aspects.

4. Recommendations

We acknowledge that a workable solution will be challenging but the passage of time has exacerbated the situation and has created an enormous amount of uncertainty. We recommend that further consultation be undertaken to revisit ways to minimise the operation of Division 7A to businesses that use corporate profits to fund business activities. The BOT report includes a number of recommendations designed to ease the compliance burden associated with the rules that govern distributions from private companies and to lower the cost of working capital for private businesses. This is a good starting point, and we welcome further consultation on the reform of Division 7A.

Black Economy Taskforce

The Black Economy Taskforce was a genuinely whole-of-government undertaking, bringing together 20 Commonwealth agencies. The Taskforce report was tabled in 2018 and had 75 recommendations most of which have been supported by the Government. Whilst the Government has made good progress in implementing some of the recommendations, we believe a new sense of urgency is required by policymakers to maintain momentum to protect the integrity of our tax system. Some of the recommendations which the Government has started scoping and require continual prioritisation to fast track their implementation are:

- ABN reforms to strengthen business identity;
- modernise business registers;
- extension of taxable payments reporting to other high risk sectors;
- introduction of a cash limit of $10,000; and
- sharing economy reporting regime (now legislated to commence on 1 July 2023).

5. Recommendations

We recommend the continual prioritisation of recommendations included in the Black Economy Taskforce report to maintain the reform agenda to protect the integrity of our tax system. The ABN reforms, and modernisation of business registers are fundamental building blocks of our tax system. Whilst we understand that these reforms require significant planning and consultation, they are critical to addressing systemic weaknesses in our tax system. The ATO's data on tax gaps indicates there is still more that needs to be done to limit the size of the black economy to a community acceptable level.

Fringe Benefits Tax

The IPA supports substantial reform of the FBT system. FBT is highly inefficient and administratively cumbersome. The complexity of the FBT system applies to all small business employer groups, including the not-for-profit sector. There are many entities trying to navigate a quagmire of rules to safely negotiate ways to comply. Whilst it comprises less than 1% of Australia's total annual revenue collections, FBT imposes a significantly disproportionate compliance cost on employers. The FBT rules have become antiquated and need reforming to reflect contemporary work practices and behaviours.

The Board of Taxation has been undertaking a Fringe Benefits Tax Compliance Cost Review involving several research initiatives to estimate and identify the basis for FBT compliance costs and opportunities to reduce such costs. The IPA supports this review and recommends that the Government take this opportunity to fundamentally reconsider the FBT in light of its disproportionately high compliance costs and, importantly, to work towards reducing the regulatory red tape. A tax that must specifically provide an exemption for the provision of toilet facilities to employees is a badly designed and poorly targeted tax. This is but one of many examples that cause FBT to be the subject of ridicule which thereby undermines the tax. The Government has recently tabled an exposure draft on reducing some of the compliance cost around FBT record keeping. We welcome proposals to allow employers to rely on existing records to substantiate a FBT liability rather than creating additional documents.

6. Recommendations

An overhaul of the FBT is warranted and overdue particularly if the Government wants to make some inroads to its commitment to reducing regulatory red tape. FBT has the unenviable title of having the highest compliance cost of any tax. It places a significant compliance burden on small business operators. There are also a number of anomalies in the FBT rules which have been allowed to exist for too long and should be addressed by any responsible government.

The IPA believes that shifting FBT from employers to employees would provide a more equitable solution to many of the current problems. This needs to be done in conjunction with simpler valuation principles which provide definitions or categories to account for non-cash payments. Taxing fringe benefits at the employee level has the potential to deliver greater neutrality in the treatment of cash and non-cash remuneration while reducing the compliance costs for both employers and employees. The Henry review supports such a proposal to simplify the current rules and provide for more transparency. If the incidence of FBT is transferred to employees, then an alternative mechanism for funding FBT tax concessions will need to be considered. These alternatives need to be considered in the interests of simplicity, fairness, and transparency. FBT is imposed at the highest marginal tax rate and very soon based on Government projections, in 2024-25 around 95% of taxpayers will face a marginal tax rate of no more than 30% increasing the urgency for a policy redesign and overhaul of FBT as we know it.

S100A - anti-avoidance rule that targets trust reimbursement arrangements still fit for purpose

S100A was enacted in 1979 to combat rampant tax avoidance and 'bottom of the harbour' schemes that were prevalent during this period. It preceded Part IVA, the general anti-avoidance rule for income tax. The main purpose of S100A was to counter aggressive trust stripping arrangements. Having regard to the nature of those schemes, it only required a tax reduction purpose, rather than a dominant purpose of tax avoidance, as required under Part IVA. Further, unlike the amendment period restrictions that apply under Part IVA, there are no time limits under S100A.
It also preceded the introduction of Schedule 2F which deals with the deductibility by trusts of prior year losses, debt deductions.

Parliament drafted S100A broadly so that it is pliable and adaptable. Only expressly circumscribed by the 'ordinary family or commercial dealing' [s100A(13)] and 'tax reduction purpose' [s100A(8)] conditions. There have been just a handful of cases providing judicial interpretation (six cases in 43 years), most dealing with artificial arrangements so there has not been much application of its broad potential. Until recently it was a less-known section of the Tax Act. Attempts to 'read down' the broad scope of S100A by reference to the extrinsic materials that accompanied its introduction have not found judicial favour to date.

There are close to one million trusts in Australia. Trusts are used as a vehicle for business, investment and estate planning by various segments of Australian society. There are many types of trusts, the most common type being discretionary trusts and S100A essentially targets these types of trusts. S100A is a critical issue in the privately held business and family wealth markets.

With the finalisation of the ATO ruling on S100A and its broad interpretation, the question that needs to be addressed is whether S100A is fit for purpose.

In view of the differences between, and the wider scope of S100A as compared to the general tax avoidance provisions in Part IVA, it's clear that the intended purpose of the policy intent at the time of its introduction was to limit S100A to aggressive trust stripping arrangements created through artificial arrangements (introduced beneficiaries with certain tax attributes). In these situations, it is appropriate to limit taxpayer protections such as time limits and the dominant purpose requirement.

One of the permitted exceptions 'ordinary family or commercial dealing' has historically been broadly interpreted by many to exclude many family discretionary trust situations. The ATO has now adopted a narrow interpretation of when the ordinary family or commercial dealing extension can apply, and by default broadening the potential scope of S100A exposing many trusts to potential scrutiny. Discretionary trust structures have many desirable features, including the ability to achieve lower tax liabilities within the family unit. As such, a tax minimization purpose is invariably part of the annual exercise undertaken by trustees before distributions are finalised.

We are of the view that Parliament should re-examine what is an ordinary family or commercial dealing, rather than the ATO, as the administrator of our tax system.

7. Recommendations

Given the broad application of S100A and its recent interpretation by the ATO, the provision should be redrafted to provide more certainty around what mischief it is targeting particularly in regard to its application around family trusts. The updated guidance does not cover all scenarios so there is added risk of whether such arrangements will be acceptable to the ATO in the event of an audit.

Despite the ATO finalising its ruling there are two full Federal Court cases on appeal which can alter the ATO's interpretation on certain aspects of S100A, so advisors are dealing with risk and uncertainty. Australia is unique in that the use of family trusts as a preferred business structure for small businesses is quite prevalent (there are 745,000 family trusts in existence).

The unlimited amendment period and no dominant purpose of tax reduction in S100A is at odds with other anti-avoidance provisions. We are already dealing with an antiquated model of trust taxation which is ill equipped to deal with the current commercial environment. Trust administration is complex enough without adding more layers to the existing administrative burden. In the absence of an appetite for broad trust tax reform we need to stem the administrative burden placed on trustees and their advisers. A lot of the small businesses using these structures are not aware of the complex administrative issues associated with their use and are unwilling to pay for specialist services to help them navigate these risks.

Small asset write-off

After 30 June 2023, temporary full expensing will cease to apply (unless there is another extension by the Government). Any depreciating assets purchased after that date will have their decline in value worked out in accordance with either the uniform capital allowance rules or the simplified depreciation rules, depending on whether or not the business qualifies as a small business entity. Many small businesses will be unaware that the small business asset will revert back to $1,000 on 1 July 2023 which is in stark contrast to the current arrangements.

8. Recommendations

We support full expensing for small business entities. The Government needs to flag its small business asset write-off policy intention particularly for small business entities. Small business needs to be given as much notice as possible to take advantage of the current full expensing opportunity before it ends on 30 June 2023. Consideration should also be given to allowing businesses to fully expense assets when they have entered into contracts before 30 June 2023 but are ineligible to fully expense due to the requirement that the asset must be first used or first installed ready for use by 30 June 2023.

Reform small business CGT concessions

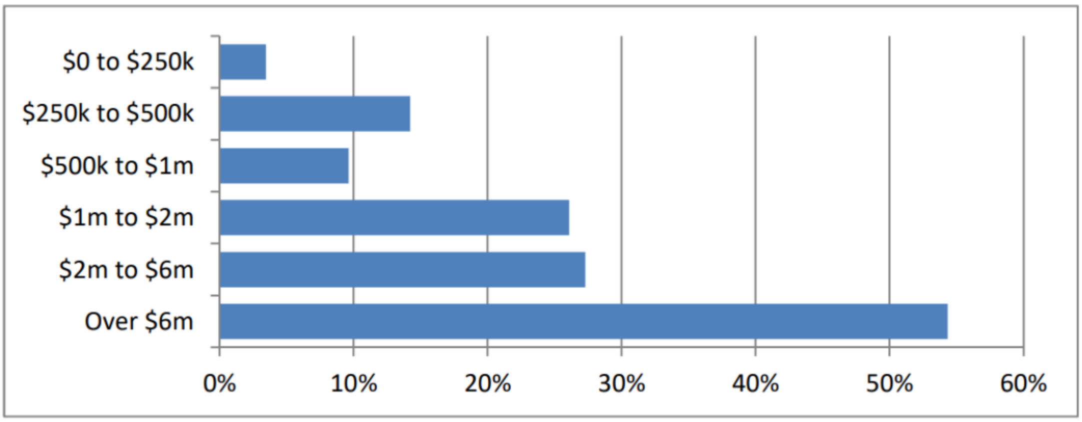
The small business CGT (SBCGT) concessions are, arguably, the most sought after and valued small business tax concession. The SBCGT concessions are a package or suite of four different concessions which enable a small business owner to defer or reduce capital gains on a sale of an active business asset. SBCGT concessions were originally intended to provide a nest egg for retirement and encourage entrepreneurial activity. However, the generosity of the concessions is matched by equally complex legislation that leads to increased compliance costs. The overall cost to the revenue is substantial and growing and changes are urgently needed to make it sustainable for the future.

They were never intended to shelter capital gains of the magnitude we are currently experiencing. As a result, the overall benefit is not as widely distributed across the small business sector with a larger proportion of the benefits being accessed by a relatively small number of businesses. Some of the capital gains being sheltered through the SBCGT concessions are considered to be excessive compared to what the concessions were originally meant to deliver. The total dollar value of claims made under the concessions grew by 16 % per annum over the three-year period 2013-14 to 2015-16, which is, arguably, an unsustainable rate.

In the 2015-16 income year, claims of $1 million or more represented 4% of all claims but accounted for some 38% ($2.37 billion) of total amounts sheltered from tax by the concessions. In the same year, there were 25 claims in relation to capital gains of between $6 million and $10 million and a further 15 claims, averaging $10 million per claim. In the previous income year (2014-15) five claimants claimed concessions on capital gains of $400 million, that is, an average of $80 million per claim.

While all categories of claims are growing over time, claims of capital gains of $6 million or more appear to show the highest rate of growth in recent years in terms of the number of claims and the total value (from $180 million in 2013-14 to $400 million in 2015-16).

Figure 5.6 - Average growth in the number of concession claims in the period 2013-14 to 2015-16



The Board of Tax in its report to Government (Review of Small Business Tax Concessions) has identified a pathway for reforming the SBCGT concessions in a way that will make the system simpler, fairer, and more sustainable. This is achieved by increasing the aggregated turnover threshold to $10 million, repealing the net asset value test (NAVT), and collapsing three exemptions into a single capped exemption.

9. Recommendations

The size of the gains that can receive preferential tax treatment doesn't align with the original policy intent and the concept of fairness and equity. We support increasing eligibility by moving the turnover threshold (from $2 million to $10 million) which will allow more businesses to qualify. We also support reducing complexity by removing the NAVT and collapsing the 15-year exemption, active asset reduction and retirement exemption, and replacing them with one CGT exemption subject to a cap. The NAVT calculations add enormous complexity to the current rules and its removal will significantly reduce compliance costs. For this to be economically sustainable, we support the introduction of a cap for the first time, on the size of the benefits that will receive preferential tax treatment under these concessions to ensure a larger proportion of the benefit is not accessed by a relatively small number of businesses.

Expand deductibility rules around education

In the 2020-21 Budget, the Government announced that it would consult on allowing individuals to deduct education and training expenses they incur, where the expense is not related to their current employment. We are supportive of initiatives that encourage individuals to continue upgrading their human capital skills over their working life. In an ever-changing labour market, few expect a job for life, and it will be more likely that individuals will have multiple careers over their lifetime. The increased rate of globalization, and technological change are other drivers that are contributing to the need for continued upgrading of skills. Our current tax settings do not support or encourage the retraining and reskilling once an individual has commenced earning an income in their chosen field.

There are a number of existing support mechanisms for higher education. We see this proposed measure as adding to the current support for higher education but also addressing a void in the existing arrangements for individuals who are currently earning an income and may be unable to access any of the existing support initiatives. For this cohort, the existing tax arrangements represent a deterrent to reskilling. In particular, the requirement for a tax deduction is limited to expenses in gaining or producing assessable income. This limits deductions to an individual's current employment activities that either maintains or improves the specific skills required for that employment or leads to an increased income in the individual's current employment. Education expenses that do not have a sufficient connection to an individual's current employment are therefore not deductible.

We see this proposal working hand in hand with the recently enacted exemption for FBT employer-provided education. The Government has exempted from FBT, employer-provided retraining and reskilling benefits to redundant, or soon to be redundant, employees where the benefit may not relate to their current employment. This allows the employer to bear the cost of retraining and reskilling without incurring FBT. To provide equity to individuals who do have employer support for reskilling or retraining, this proposal is important to extend a similar tax concession to individuals who undertake further education at their own cost. The benefit to an individual of incurring the cost themselves will, however, be dependent on the individual's marginal tax rate.

There are wellbeing and economic benefits that quality education skills provide, which generally outweigh the cost of providing further support. There is a strong business case for providing additional support especially if it is directed to areas where there is a skills shortage. The economy has been savaged by the financial impacts of COVID and we are supportive of initiatives that are aimed at improving our productive capacity. There are many skilled individuals who have been displaced and can be easily redeployed into other less affected sectors with retraining.

The proposal also bodes well for individuals who wish to continue to work but for a number of reasons may not be able to do so (ie physical limitations, age, mental burnout), and need to reskill to remain in the workplace. There are a lot of occupations where the physical demands of the job cannot be sustained beyond a certain age, and therefore retraining offers an opportunity to extend an individual's working life. This is particularly relevant if we are looking at a tsunami of baby boomers approaching retirement in the near future. We need to look at ways to add to the supply side of the labour market and this proposal, if properly targeted, can contribute to adding capacity where it is needed. Increasing the ability to claim deductions comes with a cost and therefore there needs to be integrity measures to ensure the proposal achieves good economic outcomes worthy of the tax concession.

We propose, that if this initiative is implemented, that there is a shared risk with the individual who proposes to take advantage of the concession. Quarantining half the upfront deduction until the individual earns income from an activity associated with the retraining is an appropriate model to ensure that taxpayers do not wear the entire cost of the education outlay in cases where the retraining does not result in the furtherance of a new activity. Further, for occupations or vocations that are in short supply, we should allow the full cost to be deducted upfront. Similar in concept to the discontinued 457 visa system, an occupations list that is updated to reflect industry needs can be maintained to incentivize the supply side to target the concession to where it may be most needed. Whatever integrity measures are introduced, we need to ensure that individuals do not take advantage of the relaxation of the tax rules to engage in lifestyle or personal choices subsidised by the taxpayer.

10. Recommendations

That the Government proceed with its proposal to allow individuals to deduct education and training expenses they incur, where the expense is not related to their current employment. The expanded deductibility for education expenses should be subject to appropriate integrity measures to ensure it is targeted and achieves its policy intent.

Small Business Tax Offset (commonly referred to as unincorporated tax discount)

The unincorporated small business tax discount was intended to promote neutrality by 'levelling the playing field' between incorporated (mainly companies) and unincorporated businesses (sole traders, partnerships, trusts). The majority of small businesses (up to 70%) operate as unincorporated businesses. These businesses are not eligible to access the small business corporate tax rate. The concession in its current form provides a tax benefit of up to $1,000 per individual taxpayer. In its present form the level of discount is too low to have a meaningful impact.

Progressive decrease in company tax rate and mirroring increases to the unincorporated small business tax discount

Year	2019	2020	2021	2022-2027
Company tax rate	27.5 per cent	27.5 per cent	26 per cent	25 per cent
Unincorporated tax discount	8 per cent	8 per cent	13 per cent	16 per cent

Whilst the discount rate is set to increase in line with the cuts to the corporate tax rate, the $1,000 cap remains in place meaning that most taxpayers will reach the cap amount faster and not benefit from the percentage increase. Changes to the rate of the tax discount will not be accompanied by corresponding increases to the cap which will remain at $1,000.

11. Recommendation

The unincorporated tax discount should be more targeted and prominent to small business owners by significantly increasing the cap to make it a meaningful incentive and by applying the tax discount on a 'per business' basis. At present, partnership and trusts can deliver a separate benefit of up to $1,000 to multiple individuals. The savings generated by calculating the concession in this way could be used to finance an increased cap amount.

IPA Deakin SME Research Centre White Paper recommendations

Headline findings

- Australia is yet to get closure on a comprehensive taxation debate.
- There is a reluctance at the political level to address the GST as a part of reform.
- Singapore offers an example for corporate tax reform designed to encourage the establishment and growth of new businesses.
- Incompatibilities remain to be addressed between payroll tax and land taxes.
- There is a need for a holistic review of policy objectives in relation to small business tax concessions (given the multitude of such concessions).

12. Recommendations

- The Federal Government should renew its commitment to a comprehensive tax reform process – a new process to draw on all the work already undertaken (including the Henry Tax Review and Tax Forum) in formulating a blueprint to prepare our economy for the challenges ahead. The Government should realign our tax system to reduce its heavy reliance on individual and corporate income tax.
- Parliament should engage with stakeholders to explore changes to the GST.
- The Federal Government should explore the use of a parliamentary forum (such as a committee) to seek further stakeholder views on tax reform. Such an inquiry should also use the Parliamentary Budget Office to model various scenarios.
- The Federal Government should investigate the potential implications of adopting tax incentives for new businesses, such as those operating in countries such as Singapore.
- The Federal Government should explore options with the States and Territories to either remove payroll taxes or, at the very least, to ensure the laws and the way they apply are consistent in every way across the country.
- Small business tax concessions need to be consistent, with the policy objectives as defined. A holistic review of all the current concessions needs to be undertaken to ensure the suite of tax concessions work collectively to support small businesses through all stages of a business life cycle. Small business tax concessions must be benchmarked against the policy objectives to ensure they are well-targeted and remain so. The IPA Deakin SME Research Centre supports the independent self-initiated review of small business tax concessions conducted by the BOT. The consultation guideline which sets out the principles for evaluating and improving the current suite of tax concessions for small business is an appropriate basis for undertaking a holistic analysis. Whilst the BOT review has been finalised, we are yet to see meaningful progress on its recommendations.
- That the instant asset write-off be made a permanent feature of the small business tax regime.
- A whole-of-government approach is required for small business assistance programs. Accountants are well placed to deliver such programs, as they already act as advisers to small businesses.

- To avoid incentives towards complex business structures, consideration should be given to the creation of a simplified small business entity. Our current tax rules provide an incentive for small businesses to use complex structures. Tax outcomes depend on business structures, and multiple structures are needed to achieve tax outcomes that would be otherwise unavailable through a single entity.

Enhancing Research and Development tax incentives to improve Australia's SME innovation capabilities

In July 2021, the IPA-Deakin SME Research Centre released the *Small Business White Paper 2021: Post COVID Policy Options to Enhance Australia's Innovation Capabilities*, with the primary objective of outlining a number of policy recommendations related to incentives provided in the *Tax Laws Amendment (Research and Development) Act 2011.*

Several factors motivate this focus on Australia's R&D tax incentive (R&DTI) scheme. While the Government's proposed amendments to the R&DTI scheme announced in the October 2020 Federal Budget affirm the importance of innovation to future economic growth as well as development of Australia's sovereign capability, proposed amendments to the R&DTI have led to calls for greater support to Australia's smaller businesses undertaking R&D activities. More specifically, concerns have been raised about the following issues:

The lack of collaborative research that is being undertaken by the Australian small business sector with Australia's world-renowned research institutions.

There is no government or centralised entity that both specifically promotes SME innovation and provides support to SMEs planning on collaborating with other would-be industry partners and/or research institutions, thereby increasing the difficulty in finding research partners. Accordingly, industry research partners are required to navigate sometimes complex University or research centre collaboration requirements (OECD, 2014), creating significant barriers to research collaboration.

The current eligibility criteria for R&D activity in Australia are far too narrow as they do not include software-related research activities and development, which arguably hampers the competitiveness of Australia's software industry.

Providing greater support to Australia's smaller businesses undertaking R&D activities is crucial. R&D subsidies offered by government to the business community fundamentally tackle market failures as they primarily incentivize businesses to conduct additional R&D. These tax incentives thereby address potential underinvestment in R&D in a manner that enhances positive externalities (spillovers) to the broader Australian economy (PC, 2007; CIE, 2016; Ferris et al., 2016). However, given significant financial and other economic constraints facing small businesses in Australia, coupled with the absence of federal government policy that is specifically focused on enhancing spillovers from innovation (CIE, 2016; ISA, 2016), the IPA Deakin SME Research Centre provides robust evidence showing that the current R&D tax incentive scheme can be optimised further to promote R&D expenditures, particularly among small business, to enhance externalities from innovation and R&D investment.

It is well documented that the effective costs of conducting R&D are high (OECD, 2018). While limited cash reserves are a characteristic of many SMEs and start-up businesses, and SMEs are generally constrained from engaging in R&D by liquidity shortfalls, there is abundant evidence showing that inefficient or ineffective capital (and venture capital markets, specifically) constrains Australian companies financing additional R&D (Daly, 2013; CIE, 2016; Ferris et al., 2016; ISA, 2016).

13. Recommendations

Accordingly, to improve the capacity of the R&DTI to support innovation and R&D expenditures among SMEs, the SME Research Centre in its Small Business White Paper 2021 outlines and discusses some of the following recommendations:

- Increase SME Subsidies: Despite assertions that the R&DTI provides generous incentives for Australian SMEs (CIE, 2016; Ferris et al., 2016), the magnitude of the incentive is low compared to OECD peers. Australia ranks 14th and 23rd for the strength of incentives provided to loss-making and profitable SMEs respectively, with the benefits for loss-making SMEs deriving from the refundability of the taxation credits for SMEs, rather than the magnitude of the credits. Recent changes to the R&DTI also lower the benefit received by SMEs. Where previously tax credits were offered to SMEs at a flat rate of 43.5%, tax credits will be provided under the 2020 budget planned R&DTI at a rate of the corporate tax rate +18.5%. At inception, these credits will be of equivalent value. However, with slated corporate tax rate decreases for SMEs to come into effect in the next five years, the effective cost of engaging in R&D for these companies will increase.

- We recommend reverting to the fixed rate incentive (at 43.5%) to remove the erosion of effective relief provided by the credit due to slated decreases in corporate taxation rates. The R&DTI is crucial to startups and other SMEs, and survey data gathered by StartupAUS (2019) suggests that much of this relief is directed towards expanding employment. Eroding the value of the taxation credit, and therefore increasing the effective cost of conducting R&D activities, reduces the incentive for companies to conduct these activities and employ local research expertise.1 Increasing the R&DTI may also increase incentives for start-ups and other SMEs to conduct their R&D activity in Australia, rather than overseas. Many countries provide stronger incentives than Australia and provide considerably more total funding.

- Quarterly Offsets for SMEs: An alternative way to provide cash for SMEs to invest in R&D is to provide more regular offsets that can be made redeemable. As highlighted in the 2011 Draft Legislation and exposure memorandum for the introduction of quarterly credits, this would be restricted to SMEs, as only SMEs can access redeemable credits under the R&DTI. The resulting bill, the *Tax Laws Amendment (2013 Measures No. 4) Bill 2013*, has since not been pursued by government.

- Collaboration Vouchers for SMEs: Government vouchers for innovation and R&D address several barriers to R&D collaboration. The vouchers provide direct funding to research projects, operating similar to grants addressing the limited cash resources available to SMEs and providing upfront liquidity to fund R&D, a key friction in research collaborations (CIE, 2016). For the purposes of incentivising collaboration, the vouchers provide a redeemable cash value for R&D work undertaken in collaboration with a University or publicly funded research institution. Accordingly, recipients are forced to engage with research institutions, addressing cultural frictions that would otherwise prevent industry and researchers joining on projects.

[1] This issue has been of considerable concern to industry groups. See, for example Atlassian (2020).

- Collaboration Incentives for SMEs: An alternative measure to incentivise collaboration is using indirect incentives through the taxation system. A widely considered, if not employed, approach is to provide a premium to relief rates for R&D expenses incurred while collaborating with publicly funded research institutions. The Federal Government's recent review of the R&DTI has provided strong support for a collaboration incentive. Ferris et al. (2016) provide strong support for such an incentive at the level of 20% of eligible expenditures. Based on evidence from the Department of Education's Review of Research Policy and Funding Arrangements (2015), they argue that the potential increases in business efficiency from collaborative research increases by a factor of three.

- Software and R&D: Australia adopts a relatively strict definition of eligible R&D activity. The R&DTI requires that research activity meet certain criteria. Eligible research activities must relate to experimental activities and must resolve a question for which the outcome "cannot be known or determined in advance on the basis of current knowledge, information or experience" through the application of systematic research activities. To this extent, eligible research must be "basic" research, as opposed to applied research or experimental development (OECD Frascati Manual, 2015). Thus, research must be novel – new to the world – and therefore, resolution of the issue should provide incremental knowledge spillovers.

- Accordingly, we recommend that the R&DTI be amended to (a) broaden the scope of eligible R&D activity to include software-related research activities; and (b) provide clear advice on the requirements for software to comply with the requirements of the R&DTI. This is both in line with calls from the industry (see Pakula, 2020) and the approach of foreign jurisdictions. Many countries use R&D taxation schemes to support software development. For example, Israel provides special taxation regimes, the United Kingdom includes many software development activities under its taxation offset, and the Netherlands provides both for deductions for wage expenses incurred in software development and provides a special taxation regime or innovation box.2 These incentives aid in the development of software-based industries and promote both employment in the field. Moreover, the development of internal software improves business efficiency and can increase the competitiveness of Australian businesses.

Establishing an SBA style small business government agency

The IPA has been a strong supporter of the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) from the time of its establishment and believes that more can be done to enhance its role and effectiveness in promoting the prosperity of small businesses and SMEs.

We continue to advocate for the establishment or evolution of a model based on the US Small Business Administration (SBA).

Created in 1953, the SBA helps 'small business owners and entrepreneurs pursue the American dream'. It's the only Cabinet-level federal agency fully dedicated to small business and provides counselling, capital, and contracting expertise as the nation's only go-to resource and voice for small businesses (www.sba.gov). Its resources for small business are extensive, providing business guides, funding programs (loans, investment capital, disaster assistance, grants, surety bonds), Federal

[2] Other regimes with software development eligibility include Austria, Brazil, China, Malaysia, Mexico, South Africa, Spain, Russia, Turkey, and the United States (Deloitte, 2015).

contracting, a learning platform, and advocacy. There is also local assistance – contracting, access to capital, export and trade assistance, resource partners and so on.

Its strategic goals include ensuring equitable and customer-centric design and delivery of programs to support small businesses and innovative startups, and specifically, to 'build a thriving national innovation ecosystem that promotes investments in all small business communities'.

We appreciate that Australian agencies undertake many of these functions, though perhaps not as extensively and not in one place. Bringing all of these enhanced functions and resources into one agency would benefit small business people and other consumers, making it significantly easier to navigate the plethora of government support. Despite the concierge service at ASBFEO and at state based small business commissioner offices, there is still confusion and complexity in the Australian model.

We would be pleased to discuss this model further and share our experience with the SBA and its development of a small business ecosystem, which we brought to Australia and developed with Deakin University and other stakeholders, including the Treasury, back in 2019.

14. Recommendation

The Government should explore establishing an SBA style agency as a one-stop-shop for small business and SMEs.

Workplace relations – the need for simplicity

The small business sector is an important employer of labour and contributes significantly to the Australian economy. However, the sector is diverse. While not all small private-sector businesses employ people, 798,000 (or almost 38.0%) are employers of labour, employing 4,731,000 (or over 44.0% of all employees).

Small business owner-managers who employ face many challenges in managing their human resources (HR), especially if they want to grow their businesses. An important distinction to make relates to whether an owner-manager is growth-oriented. This will significantly impact how the business is likely to be managed in a sustainable way, noting that small businesses have a higher failure rate than their larger counterparts.

While the workplace relations system is sometimes seen as imposing unnecessary compliance costs on small businesses, the system provides for flexible work arrangements that are not necessarily accessed by small business owner-managers. It also provides owner-managers with key standards or benchmarks, so they can readily determine what to offer their people in terms of pay and other terms and conditions of employment. These are readily available and easier to understand than in the past.

Businesses that rely on paying their people (minimum) award terms and conditions are less likely to succeed. Business owner-managers who do not demonstrate that they value their people are less likely to achieve such results[3].

[3] Fox and Smeets (2011); Ichniowski and Shaw (2003); Lazear (2000).

15. Headline findings and recommendations

- The small business sector is often perceived in the business and political media as a homogeneous group. It is, however, very diverse and a critical distinction needs to be made between growth (entrepreneurial) and non-growth-oriented owner-managers. While the latter group is numerically significant, growth-oriented entrepreneurs, in the main, do the heavy lifting when it comes to new job creation. New and small businesses are subject to vulnerabilities – that is why the survival rates are relatively low for such businesses. The longer they survive and the more they grow, the more sustainable they become. Growth-oriented businesses have the opportunity to contribute more significantly to employment growth.

- Owner-managers of small businesses, including entrepreneurs, will benefit from a workable workplace relations framework that delivers consistency and stability. Such owner-managers are time-poor and lack resources to deal with too many ongoing changes, particularly of a significant nature.

- Continued effort is required to ensure small business owner-managers understand their legal rights and responsibilities with regard to workplace relations. To achieve this:
    - Easy-to-understand regulatory material needs to be readily available. The efforts of the Fair Work Ombudsman (FWO) have been welcomed.
    - Small business owner-managers should be given the opportunity to make enquiries regarding workplace relations matters anonymously (to encourage a more accurate, timely information flow).

- Penalty rates are a highly contested area of the workplace relations landscape. They were introduced as a deterrence against the use of longer, unsociable working hours by employers, as well as to compensate employees for working such hours. Over time, consumer preferences have changed to longer trading hours in the retail and hospitality sectors. The Fair Work Commission (FWC) has addressed this issue and these efforts should continue.

- The main direction and operation of Federal unfair dismissal provisions appear to be fulfilling important fairness and justice standards and need to remain. We note that the Productivity Commission, in its review of the workplace relations framework, did not see any evidence to justify removing such provisions. Importantly, it concluded that unfair dismissal provisions are not playing any significant role in employers' hiring and firing decisions.

- Due to resource constraints experienced by small business owner-managers, it is important that regulators, at all levels of government, continue to address and remain vigilant to the compliance burden. Regulatory requirements need to be simplified and associated cost-burdens minimised where they are unable to be removed (such as with the wording and administration of awards and the inspectorate role of the FWO).

- While improvements to the workplace relations system will continue to be important in addressing any anomalies and modernising outdated provisions, substantive and sustainable improvements to business productivity and competitiveness are more likely to arise from changes made at the firm level. Major differences in productivity and competitive advantage will be shaped, to a large extent, by what happens in specific workplaces and not so much by legislative or governmental changes at the national level.

Net employment dynamics of Australian SMEs

Since its inception in 2013, the IPA-Deakin SME Research Centre has been tracking the economic behaviour of SMEs in Australia, analysing, and highlighting the performance of these businesses in relation to financing, innovation, skills and human capital, competition, and regulation. We also consider the net employment of Australian SMEs and the relationship to size, age, and innovation.

While evidence in the literature suggests that employment growth is generated by a few rapidly growing firms in a number of developed economies[4], these high-growth firms are not necessarily small and young. More importantly, to date there is limited evidence on better understanding employment growth in Australia in relation to firm characteristics such as size, age, innovation, and other firm factors.

We address the gap in the literature by focusing on these specific SME firm characteristics and their contribution to Australia's net employment by using the Australian Bureau of Statistics' (ABS) Business Longitudinal Data. SMEs are an important contributor to the Australian economy and are a major source of employment for Australians. SMEs often provide more employment opportunities for unskilled workers, thus they help to drive down the unemployment rate, which can have positive flow-on effects to Australian society in general by lowering the crime rate, decreasing welfare dependency, improving standards of living, and so on.

For decades, economic policy-making and research has been influenced by the assumption that business growth is independent of firm size. More recently, however, economic research has questioned this assumption by demonstrating that small firms grow faster than larger firms and that smaller enterprises are a more important source of job creation in the economy. Indeed, a body of research on employment shows that employment growth is actually dependent on the size of the enterprise, with some empirical evidence indicating that job growth is inversely related to firm size.

Notwithstanding this inverse relationship between employment and firm size, we also note that there are significant, persistent productivity differences between different SME firm size and age classes that possibly affect both firm survival and growth. Moreover, the extant literature[5] reports that the entry, exit, expansion, and contraction of firms are significantly associated with various measures of productivity and profitability.

The concept of 'creative destruction' – a term coined by Austrian-American economist Joseph Schumpeter in 1942 – is an important feature of competitive markets that are dominated by small firms. The concept describes what happens when new entrepreneurial small businesses challenge existing incumbents, driving productive 'churn' whereby inefficient firms exit and the efficient grow. The efficient reallocation of resources between these growing and shrinking firms is critical to aggregate productivity growth and employment.

Accordingly, we examine net employment among SME firms by considering whether size, age, and innovation (and the type and processes of innovation) are important determinants of net job creation among SMEs in Australia. We draw on work undertaken by the IPA Deakin SME Research Centre[6]. Understanding these SME firm dynamics will assist in formulating better policy outcomes regarding job creation in the SME sector.

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[4] Henrekson and Johansson (2010).
[5] See Syverson (2011); Foster, Haltiwanger and Krizan (2001).
[6] See Cowling, Kiaterittinun, Mroczkowski and Tanewski (2018).

16. Headline findings and recommendations

- We show that both business size and age are significant determinants of net employment, particularly among start-ups and young firms.
- As firms become older, they contribute significantly less to net employment, whereas younger firms (ie less than 5 years old) have a significant impact on net employment, contributing on average to around 15% in net employment.
- Start-ups and young firms that innovate, particularly those associated with the introduction of new marketing methods, contribute on average to between 7% and 9% in net employment.
- Another significant determinant of net employment is government financial assistance, contributing on average approximately 3% to job creation.
- Our analyses demonstrate that start-ups and young firms are important drivers of net employment in Australia and, when considering the effects of age and innovation together, we find that these factors significantly contribute to job creation and are important sales growth and performance differentiators.
- Our results show compelling evidence that the innovation capability of start-ups and young firms underpins the observed firm-employment dynamics, significantly influencing employment outcomes in the Australian economy.
- An important policy objective, therefore, is the early identification of start-ups and young firms that have innovation capabilities, as these firms contribute significantly to net job creation.

Innovation policy – it's never been more critical

Given that innovative firms (particularly start-ups) are known to create more jobs than any other business category[7], Federal, State, Territory and local governments in Australia must do everything within their scope to assist businesses in understanding the value of innovation and, where appropriate, to provide financial and other incentives to encourage innovative thinking within the small business community.

However, there is still an apparent lack of appropriate acknowledgement by small businesses of the importance of innovation to the growth of their enterprises. The IPA Deakin SME Research Centre[7] has noted that the ABS reports that only one in seven small businesses see innovation as important. That statistic alone illustrates that more needs to be done to create and promote incentives for small businesses to improve their prospects of future success.

The IPA Deakin SME Research Centre has undertaken research on R&D in the wake of COVID-19 and concludes there is an urgent need for new thinking in stimulating SMEs through innovation. A major innovation is the patent box. Whilst this has been introduced in Australia, there is room for considerable expansion (see below).

Headline findings

- Innovation is a key driver of productivity, jobs creation and economic performance.
- Innovation policy should include measures that encourage the diffusion and uptake of existing innovations by a broad range of firms, as well as encouraging new innovations per se.

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[7] Cowling, Tanewski, and Mroczkowski (2017)
[7] IPA-Deakin SME Research Centre (2018b).

- Federal, State, and local governments in Australia have a series of grant schemes available for small businesses seeking to grow.
- Government agencies have extensive small business education programs designed to assist small businesses working within the innovation space.
- Public policy to support innovative SMEs should increasingly consider value capture and business model innovation generally.
- Businesses in Australia experience a wide range of barriers to innovation. This suggests policy to support innovation needs to be flexible and broad-based.
- Talent, not technology, is the key. If wider skill requirements are not addressed, there are likely to be bottlenecks created downstream in the innovation process.
- Technical skills across the workforce, and particularly interdisciplinary skills that bridge areas of expertise, are particularly important for innovation and are often subject to market failures.
- Patent box initiatives continue to gather momentum in offshore jurisdictions.

17. Recommendations

- Governments should provide more support for R&D by small and medium-sized firms.
- Better linkages should develop between cutting-edge research universities and industry. Typically, only large firms have the resources to fund university-level research and development.
- Governments should provide more support for firms to adapt existing technologies and innovation.
- Measures should be developed and implemented to help the spread of existing innovations to a broader range of firms.
- Encouragement should be given to firms to adopt 'continuous improvement' methods to embed incremental innovation, as this will generate large productivity improvements quickly.
- The Government should provide tax breaks for companies acquiring new technologies not developed in-house.
- A 'matching' service should be developed to promote the building of collaborative relationships between multinational corporations and Australian businesses, both domestically and abroad.
- The Government should provide a tax allowance for companies investing in intellectual property protection (through patents, copyright, trademarks, design rights etc) in-house.
- The Government should provide tax allowances for companies that generate licensing income for in-house new technologies.
- The Government should rigorously continue with patent box initiatives.
- The Government should further develop government procurement initiatives to ensure small business procurement targets are met and exceeded within a specified timeframe. These programs could be based on programs that are running in the United States.
- The Government should allocate a pool of funds for further research into youth entrepreneurship in Australia, so policy decisions made in this area are based on research evidence.

Trade policy and the need to internationalise

The role of international trade is crucial to the development of national economies in many countries, including Australia[8]. As demonstrated in the White Papers, SMEs play a critical role in contributing to Australian employment and economic growth. But how significant are SMEs in the international trade of Australia?

We have focused on the international activities of SMEs, particularly their exporting behaviour, including:

1. The main ways in which SMEs enter export markets
2. Types of SMEs that are most likely to be involved in exporting
3. Exporting performance of Australian SMEs
4. Policy implications.

18. Recommendations

We draw on a range of research literature and Australian official government data to provide a basis for discussion on the performance of Australian SMEs and make suggestions for Australian policy makers. Certainly, there is much to be done to help Australian SMEs 'raise their game' in the international marketplace and especially in terms of trade diversification to help on the road to post-COVID recovery. The evidence presented shows a weak international performance by SMEs but also grounds for optimism.

- Findings from the longitudinal study by ABS suggest the majority of small and young firms are still more domestically oriented, compared with larger firms. In terms of policy interventions, a targeted approach is suggested, aimed at those SMEs that are seeking to internationalise but have not yet done so, and those that are already exporting and are seeking to expand their international reach into additional new markets. Hence, the strategy should be to build upon current successes and to increase the volume of direct exporters. Inevitably, such an approach requires some targeting of different categories of SMEs with specific types of support.

- Australian interventions should place more priority on facilitating SME exports in the six most internationally-active industries – including mining, agriculture, manufacturing, wholesale, information media, and professional services. These are the main sectors in terms of generating export revenue for the economy. However, as geographic sales of SMEs vary across sectors, this suggests that a tailor-made intervention for each sector is highly recommended to boost the rate of internationalising SMEs. Tailor-made interventions are much more likely to be relevant and effective and would encourage higher levels of take-up by SMEs.

- Size and age of enterprise are also important when designing and delivering support measures. As revealed in the longitudinal data (ABS), the significant difference in the level of international involvement between medium-sized and self-employed firms can be attributed to two reasons: their limited resources (which adds costs and risks in engaging

[8] OECD (2017).

internationalisation) and/or their lower levels of motivation to go beyond their local markets because of their resistance to grow (risk aversion). On the other hand, born globals (who are highly motivated to internationalise) may encounter more challenges in accessing finance, compared with their counterparts, due to the higher risks involved and less-developed networks and lack of experience in the foreign market. Hence, more emphasis should be placed on encouraging small and self-employed firms to participate in foreign markets by providing targeted export incentives, support for networking and international collaboration, business matching opportunities, and facilitating access to finance.

- Innovation has been acknowledged in literature as a critical factor in enhancing internationalisation. Investment in innovation also contributes to developing competitive advantage for firms to outperform others in the international market, as well as to increase sales revenue. Evidence suggests that innovation is more intensive in Australian exporting SMEs than non-exporters. Hence, support for growth and innovation can be helpful to boost the number of exporters and accelerate their international activities.

- In the increasingly uncertain global environment, SMEs would benefit from clear guidance and signposting to identify and assess the risks of internationalisation. More support in terms of detailed information provision would be helpful, such as the provision of tailored advice and a mentoring program for firms internationalising in different geographical markets. In-depth discussion forums and network events, such as how to evaluate the impact of free trade agreements and opportunities for Australian SMEs and challenges emerging from the policies of foreign governments, should be offered, or continue to be offered and strongly supported. This will not only help the government to understand SMEs' needs, but it will also build a bridge between SMEs and policy makers in designing specific instruments to support their internationalisation. We applaud the work which the Dept of Foreign Affairs & Trade has done to promote the utilization of trade agreements and hope to see this work continue and be strongly supported by the Government.

Mental health: significant economic implications

The IPA Deakin SME Research Centre received over $3 million in government funding for its "Supporting Small Business Advisors for Better Mental Health" project to train accountants, accounting technicians and financial advisers. The program was rolled out in 2021 and was extended into 2022. It trained nearly 4,000 advisers to assist their small business clients and also themselves.

The Research Centre extended the project to include the other two professional accounting bodies, Beyond Blue, WorkSafe Victoria, Mental Health First Aid and other relevant organisations.

Accountants, as trusted advisers, are on the frontline and are often the first to recognise such stressors amongst their clients, particularly SMEs. However, to make a significant and sustainable improvement to mental health and to address the economic and financial impact, there needs to be a holistic approach. In this regard, the IPA acknowledges the Productivity Commission *Mental Health* report released in June 2020 and supports the detailed recommendations.

We applaud government investment in mental health and the previous Government's response to both the Productivity Commission inquiry into Mental Health and the National Suicide Prevention

Adviser’s Final Advice, including measures in the 2021-22 Budget, together with $2.3 billion in additional funding.

19. Recommendation

The IPA urges the Government to continue the investment in mental health and wellbeing, especially for small business people and their advisers.