PRE-BUDGET SUBMISSION 2024-25

January 2024

Introduction

The Institute of Public Accountants (IPA) Group welcomes the opportunity to present our pre-Budget submission for the 2024-25 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 small to medium sized enterprise (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 the rate of productivity growth; and in easing the disproportionate regulatory compliance burden on small business and SMEs.

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. In 2023 and 2024 further white papers were released on governance of the ATO and on Commonwealth government grants.

Published White Papers can be accessed via the IPA website at, white papers.

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.

For many years now, the IPA has expressed its disappointment at the lack of political will of successive governments to embark on holistic tax reform, or even to start a meaningful conversation with the public and with the business community. Nevertheless we will continue to voice our views that holistic tax reform (including the GST) is essential to our future prosperity.

The primary purpose of the IPA Deakin SME Research Centre white paper entitled, *Commonwealth Government Grants 2018 to 2022,* the first in a series, is to provide transparency to an otherwise shrouded process, and thereby enhance government accountability for a significant amount of taxpayer funds.

In addition, the IPA urges the Government to commit to a progressive innovation policy. We refer to 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*, which are still relevant.

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

Vicki Stylianou
Group Executive, Advocacy & Professional Standards
Institute of Public Accountants

COPYRIGHT© Institute of Public Accountants (ABN 81 004 130 643) 2013. All rights reserved. Save and except for third party content, all content in these materials is owned or licensed by the Institute of Public Accountants (ABN 81 004 130 643).

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 economic significance of the small business sector, it has the potential to positively influence productivity growth. Australian small businesses 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.

Further information, including research findings can be found in the published white papers.

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.

1. Recommendations

1.1 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.

1.2 The Government should contribute to and be guided by the work of the OECD in enhancing global awareness of and applying good regulatory practice.

1.3 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.

1.4 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.

1.5 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 preCOVID-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, higher interest rate and structural expenditure risks, such as ageing, defence, NDIS, interest servicing costs on debt and transitioning to a green economy will present fiscal challenges in the years ahead. The latest version of the Governments Intergenerational Report (2023 *Intergenerational Report*) highlights these pressures on our fiscal sustainability.

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 uncertainty around the long run fiscal sustainability, 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. This represents a disproportionate burden on personal taxpayers in the years ahead unless corrective action is taken, and the tax base is broadened.

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 putting pressure on personal taxes to carry the load.

The base and rate of our GST will also hamper the Government's ability to maximize revenue from this direct consumption tax. 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.

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, and lower tax concessions.

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 Pay Day Super and Superannuation Guarantee (SG), Division 7A, Fringe Benefits Tax (FBT) regime, small business Capital Gains Tax (CGT), Small Business Tax Offset, Individual Residency Rules, taxation of trusts and the recommendations from the Black Economy Taskforce.

Payday Super and Superannuation Guarantee penalty regime

The 2023-24 federal Budget unveiled a new initiative, the Securing Australian's Superannuation package, commonly referred to as Payday Super (PDS), which will be a significant change to the current arrangements. Starting from July 2024 the initiatives aim is to synchronise superannuation contributions with the employer's payroll cycles. One of the other stated aims is to enhance the ATO's capacity to proactively detect instances of unpaid or underpaid super. The reform seeks to lessen the reliance on employee complaints, by proactively identifying discrepancies, and enabling swift intervention and resolution.

PDS represents a significant departure from the existing arrangements where the payment of employees' salaries and wages is separate to the payment of their superannuation entitlements. Over 60% of employers pay their SG contributions quarterly, so PDS will inevitably be one of the most significant changes to the superannuation sector since compulsory super began. The existing system has many issues that need to be addressed, so that they are not dragged into the new regime. PDS should not proceed without system improvements addressing the current identified drawbacks, otherwise we will be introducing additional unnecessary complexity into the new regime. The use of SuperStream, clearing houses, super choice/stapling and remittance processes need to be refined and streamlined to support the move to near real time payment of SG.

The proposed policy changes will impact a wide range of legislative provisions, employers' compliance requirements, the onboarding of employees with an employer, payment and reporting systems and processes, services provided by intermediaries (including payroll providers, clearing houses and practitioners), and administration by the ATO (ATO or the Commissioner). As a result, every aspect of the policy and its impact needs to be carefully considered. Otherwise, there is a high likelihood of significant and unintended consequences that may affect employers' ability to comply with the PDS model. Process improvement of the current systems is required as there is only a small window for error corrections to accommodate the proposed more frequent payment of SG.

More frequent SG contributions will lead to higher costs for employers by way of processing costs and higher transaction and servicing costs. In addition, the cashflow consequences for employers cannot be ignored especially for small and medium businesses. The move to immediate payment may pose challenges during the transitional period where the old and new regimes overlap, and

some entities, in particular smaller employers, may collapse under this strain, as the proverbial 'straw that broke the camel's back' syndrome.

The current penalty regime for late payment or underpayment of SG needs to be changed. We consider that the Superannuation Guarantee Charge (SGC) model in its current form is overly complex and punitive. The design of the SGC and the associated penalties deter self-rectification, and they therefore operate as a disincentive for employers to voluntarily report and rectify historical shortfalls. One of our key concerns is the draconian application of penalties that do not proportionately reflect the loss to employees or the 'culpability' of an employer who is in arrears.

A lot of the issues raised above are contained in a joint bodies' submission, in response to the consultation paper '*Securing Australians' Superannuation*' which includes a lot more detail about the issues that need to be addressed as part of the new PDS regime.

2. Recommendations

Process efficiencies

2.1 To improve process efficiency, all known existing issues need to be addressed before we implement the new regime of real time payment of superannuation entitlements with the employer's payroll cycle. The proposed implementation timeline allows for careful consideration of all the existing inefficiencies to streamline processes under the new PDS regime. The proposed change to a PDS model is complex and its successful implementation depends on a multitude of factors. We trust that the detail included in the joint bodies submission(Submission-23-11-08-Joint-submission-Treasury-Payday-super-final.pdf (publicaccountants.org.au)) will assist the Government and relevant government agencies to better understand the underlying issues and design the system to best achieve the underlying policy intent while being simpler, more efficient and equitable.

Penalties

2.2 Late payment penalties under the existing penalty regime for failure to make SG payments on time need to be revised. PDS represents an overdue opportunity to completely redesign the SG penalty regime, to make it simplified and less punitive for employers trying to do the right thing. It must deter bad behaviour, whilst encouraging employers to quickly identify and fix errors. A fairer and proportionate penalty regime must be introduced to differentiate between infrequent late paying employers and deliberate non-paying employers.

Compliance and cashflow

2.3 The compliance and cashflow impacts on small and medium businesses warrant consideration of a staggered implementation timetable similar to what was used when single touch payroll (STP) was introduced. The implications on small and medium business entities are not insignificant moving to a PDS model for SG contributions. An extended timeframe also provides more time for unforeseen issues to be ironed out prior to implementation for all other employers. Similar to the staged STP implementation, the ATO could require compliance with the new SG payment timeframes from 1 July 2026 for those employers with at least 20 employees immediately before 1 July 2026. All other employers could be required to comply 12 months later; that is, from 1 July 2027. Also, as with STP, a very small number of (mostly) micro-employers may not be able to comply with any new SG

payment requirements, be impacted by exceptional or unforeseen circumstances as outlined in PS LA 2011/15 or run their business in an area with no internet service. In these cases, the ATO should be able to administratively exempt these employers, on a case-by-case basis.

Tax Advisory Board – enhancing accountability and governance

Former Treasury Secretary, Dr Ken Henry's Tax review in 2009, highlighted that some improvements could be made to the ATO's governance and accountability, and hence Henry's review recommended an Australian Taxation Advisory Board. In August 2010, the Gillard Government announced that it would establish a Tax System Advisory Board that would advise the Tax Commissioner and the ATO Executive Committee on strategy, direction, culture, organisation, management, compliance planning, staff profile and information technology plans at the ATO, as well as provide a new, direct and in-built voice for business and taxpayer communities in relation to ATO decision making and culture.

After much consultation with the Australian community, a Tax System Advisory Board Consultation Panel released a report in June 2011 to the Gillard Government, in which it provided nine recommendations, one of which was, to establish an advisory board.

The IPA commissioned Deakin University as part of its SME Research Centre to review governance and accountability of similar taxation authorities in the international context.

The research concluded that the governance and accountability of the Australian tax system can be significantly improved by adopting a Tax System Advisory Board. Australia already has an established 'blueprint' for the creation of such an Advisory Board, which was recommended in June 2011, with widespread community support, and which would make adoption of such a board seamless, less costly and less time constrained. Furthermore, several countries (i.e., Canada, Finland, Sweden, UK, USA) have created either 'management boards' or 'advisory boards' that are interposed between the revenue body such as the ATO and the relevant minister such as the Federal Treasurer, to provide a degree of independent advice on the plans and operations of the revenue body and tax administration arrangements in general. Whilst the specific functions of these boards vary between countries, all execute an oversight function and appear to play roles in strategy development, planning and sign-off of formal business plans. Without exception, board members are not involved in issues concerning the tax affairs of individual taxpayers and do not have access to specific taxpayer information. Accordingly, creation of an Australian Tax System Advisory Board would not only improve the oversight and strategic functioning of the ATO, but it would significantly improve the transparency and adherence to the *Taxpayer Charter* which has been recently renamed '*Our Charter*" and make the operations of the ATO more accountable.

3. Recommendation

3.1 The governance and accountability of the Australian tax system can be significantly improved by adopting a Tax Advisory Board. We recommend the creation of a similar Australian Tax System Advisory Board as recommended by the Henry review and the Tax System Advisory Board Consultation respectively.

Individual Residency Rules

The Australian tax residency rules for individuals, in their present form, have long caused taxpayers to face a heavy compliance burden. This is due to the inherent complexity of the residency tests in Australia's domestic tax law, which demand an analysis that is highly subjective and factual, and where the legal principles are far from clear, and constantly litigated.

This presents considerable difficulties in the context of our self-assessment tax system. Our members tell us that many individuals cannot plan their affairs or manage their tax compliance with certainty. Advisors face significant risk when advising on the residency tests and many will recommend to their clients that they obtain (at significant cost and delay) the assurance of a private binding ruling from the Commissioner of Taxation (Commissioner).

The case for change is strong. The current Australian tax residency rules for individuals can be fairly described as outdated and incompatible with the modern world, where increased global mobility, advances in technology and evolving economic and social norms, have dramatically changed the way that individuals live and work: the world is a very different and much smaller place today than what it was at the time the rules were first introduced some eighty years ago.

In 2019 the Board of Taxation (Board) released its final report *Individual Tax Residency Rules – a model for modernisation* (the 2019 report) to the former Government. The 2019 report made 22 recommendations, the principal recommendation being to replace the income tax residency rules

for individuals with the Board's proposed model. On 11 May 2021, the former Government announced that it would replace the individual tax residency rules with a new, modernised framework, based on the model recommended by the Board in its 2019 report. During September 2023 the current Government released the consultation paper titled '*Modernising individual tax residency Rules*' based on recommendations made by the Board to seek community feedback on the proposed development of robust principles that will underpin an enduring framework for an individual tax residency framework.

The IPA strongly supports the proposal to reform and modernise Australia's individual tax residency rules as contained in the consultation paper. Overall, we consider the Board's proposed reforms to the Australian residency tests for individuals to be positive and superior to the rules which currently apply.

In particular, we welcome the focus on greater objectivity in the application of the tests, which we consider will lower the compliance burden for taxpayers when seeking to obtain certainty about their residency position in Australia. By anchoring the rules to matters that can be objectively ascertained, such as physical presence in Australia, taxpayers and their advisors will be better placed to self-assess how the rules will apply to them and their circumstances. Taxpayers will have a more solid basis upon which to structure their affairs and comply with their Australian tax obligations with a greater degree of certainty. We anticipate this will achieve compliance efficiency and should reduce the need, and consequently the cost, for taxpayers to seek administrative assurance in the form of a Private Binding Ruling from the Commissioner. It should also reduce the risk that taxpayers will find themselves in dispute with the Commissioner, which often culminates in litigation.

However, we believe there is considerable scope to reconsider and recalibrate aspects of the proposed rules, to ensure the rules better reflect and respond to the practical circumstances that will be encountered by the majority of taxpayers.

Importantly, we consider there is scope to introduce some flexibility and discretion in the rules, aimed at reducing the risk of the rules producing an outcome that is unjust or unreasonable, without diluting the certainty or objectivity of the rules to a substantial degree for the majority of taxpayers.

One aspect of the reforms which the Board has proposed, which is of greatest concern to our members, is the '45-day requirement' in the secondary commencing residency test.

We consider that a period of 45 days would likely result in a greater number of individuals being Australian residents. This is contrary to Treasury's statement in the consultation paper that the proposed model is not intended to capture more individuals as tax residents or raise any additional revenue. This also does not accord with the principle of adhesive residency, which provides that it should be harder to cease, than to become an Australian tax resident.

The 45 day requirement would also increase overall compliance costs, which detracts from the certainty and simplicity sought to be achieved with the proposed model, as any individual present in Australia for 45 days or more in a year would need to consider whether they are a resident under the secondary test, and then consider the application of any relevant international tax treaties.

Based on the feedback we have received from our members, a period of 45 days may stifle inbound economic activity, whereas a period of 90 days would be better aligned with practical experience and circumstances of most taxpayers and will provide greater certainty and a reduced compliance burden for a majority of taxpayers. The consultation paper suggests that the 45-day requirement has an anti-avoidance purpose which is aimed at preventing taxpayers manipulating the rules to obtain an unfair or unintended tax benefit. Respectfully, if that is the policy objective, it can be better achieved by specific and targeted anti-avoidance provisions, which target those taxpayers who look to manipulate the rules, without placing an undue compliance burden on the vast majority of taxpayers who are focused on compliance and desire certainty. Lastly, the interaction of our domestic residency rules with outcomes for countries with which we have double tax agreements, should be within scope, as part of future reforms.

4. Recommendation

4.1 The Government proceed with 'Modernising individual tax residency' in line with the Board of Taxation recommendations. There are aspects of the Board's recommendations that could be recalibrated, to ensure the rules better reflect and respond to the practical circumstances that will be encountered by the majority of taxpayers. Our submission to the consultation paper titled 'Modernising individual tax residency' released by the Government based on the Board's recommendations provides further detail of our recommendations for consideration.

Taxation of trusts

Trusts are commonly used for holding investments however, Australia is unique in that the use of family trusts as a preferred business structure for small and medium businesses is quite prevalent (there are over 1 million trusts in existence and the majority are discretionary trusts commonly referred to as family trusts).

Despite their popularity, the current taxation of trust regime is overly complex and becoming a compliance burden for taxpayers. It is an antiquated model of trust taxation which is ill equipped to deal with the current commercial environment. There have been many recent trust law decisions (*Bamford, Carters and Greensill* to name a few) over the last fifteen years, adding more layers to the existing administrative burden or exposing their complexity. In addition, there have been significant changes to some ATO rulings (UPE's, S100A) relating to trusts. 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 and medium 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.

Section 100A was a recent example of the complexities around trust administration. Until recently it was a less-known section of the *Income Tax Assessment Act 1936* (ITAA 36). Section 100A essentially targets discretionary trusts. 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. Section 100A is a critical issue in the privately held business and family wealth markets.

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, broadened the potential scope of S100A, exposing many trusts to potential scrutiny.

5. Recommendations

5.1 The rising compliance burden on small and medium businesses using trusts needs to be addressed. A review of the taxation of trusts is overdue and some balance between upholding the integrity of the existing regime, whilst minimising the compliance burden is urgently needed. Even the ATO is challenged in trying to administer the taxation of trusts and the ongoing changes to case law impacting trusts. The ATO has a dedicated page on its website on the current challenges, *Current issues with trusts and the tax system* | Australian Taxation Office (ato.gov.au).

5.2 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 ATO 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.

Division 7A: reduce uncertainty around future changes

The Government has acknowledged that Division 7A needs urgent reform. The previous 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 previous Government deferred the start date again to 1 July 2020. The latest update from the previous 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. Some aspects of the recommendations from the Treasury consultation paper are of a concern such as the removal of the concept of distributable surplus.

6. Recommendation

6.1 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. Division 7A and UPEs are back in the spotlight following the recent AAT decision in Bendel v FCT [2023] AATA 3074 which decided that an UPE between a corporate beneficiary and trust did not constitute a 'loan' under s109D(3) ITAA 1936. The Bendel decision challenges the ATO's views in TD 2022/11 and TR 2010/3 before that, which treats these UPEs as loans for the purposes of Division 7A. The Commissioner has appealed this decision to the Federal Court. 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).

7. Recommendation

7.1 We recommend the continual prioritisation of outstanding recommendations included in the Black Economy Taskforce report to maintain the reform agenda to protect the integrity 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 level acceptable to the community.

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 and medium 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. 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 enacted some measures to reduce 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.

8. Recommendation

8.1 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 and medium 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 (based on the original Stage 3 tax cut modelling), 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. Despite the announced changes to the Stage 3 tax cuts, reform of FBT is still urgently needed and is long overdue.

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

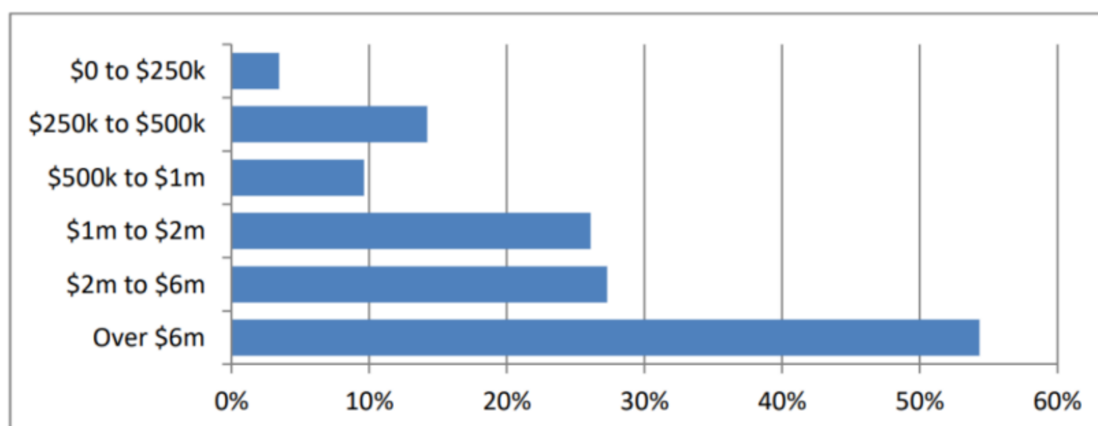
equally complex legislation that leads to increased compliance costs. The overall cost to the revenue base is substantial and growing and changes are urgently needed to make it sustainable for the future.

SBCGT concessions were never intended to shelter capital gains of the magnitude that 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* March 2019) 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. The data noted above has been extracted from the Board's report on Small Business Tax Concessions. This is the latest publicly available information that analyses this tax concession and we are of the view that the trends highlighted are still prevalent.

9. Recommendation

9.1 The size of the gains that can receive preferential tax treatment don'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 saw 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 not have employer support for reskilling or retraining, it 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. 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. Recommendation

10.1 That the Government reconsider the 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

11.1 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, partnerships 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. Small businesses have incurred more compliance costs over the years due to digitalisation, cyber security etc and this initiative is a way to compensate such entities for this added burden. Some of these additional burdens are mandatory government initiatives (Single Touch Payroll, complying with Privacy Act etc).

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.* Our recommendations are still relevant.

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).

12. 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:

12.1 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 corporate tax rate decreases for SMEs, the effective cost of engaging in R&D for these companies will increase.

12.2 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.

12.3 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. It appears the resulting bill, the *Tax Laws Amendment (2013 Measures No. 4) Bill 2013*, has not been pursued by government.

12.4 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.

12.5 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.

12.6 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

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

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.

12.7 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 UK 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.

Innovation policy – it's time to get serious

The IPA's concerns relating to innovation policy are supported by the findings of the Productivity Commission in its *5 Year Productivity Inquiry: Innovation for the 98%*, released in February 2023. We refer to the Preface:

Between 1 and 2% of Australian businesses innovate in ways that are new to the world. Such leading innovations can promote productivity, but there are already many policies in place to promote them. What of the neglected 98% for which the potential for, and desirability of, new-to-the-world innovation is weaker? Much productivity improvement involves the wider adoption of established, even dated, technologies and practices among those millions of businesses.

There is a large group of Australian businesses whose management practices, uptake of technology and productivity are below their best practice peers. For example, many businesses undertake little or no assessment of their performance, though this is a major motivator and route to improvement. It is not possible for all businesses to achieve best practice because of large variations in managers' and employees' aptitudes and preferences, and the operating environments of firms. However, by

incrementally improving the performance of those businesses, higher rates of diffusion of best practice could significantly lift aggregate productivity growth.

There are worrying signs that some of the principal vehicles for acquiring and transferring knowledge are dormant or slowing.

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

In addition to R&D tax incentives, there are other mechanisms open to government to encourage and support innovation across the economy.

Given that innovative firms (particularly start-ups) are known to create more jobs than any other business category[3], 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.

Some of the headline findings from the IPA Deakin SME Research Centre since COVID-19 include:

- 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.
- 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.

13. Recommendations

13.1 Governments should provide more support for R&D by small and medium-sized firms (refer above).

13.2 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.

13.3 Governments should provide more support for firms to adapt existing technologies and innovation.

13.4 Measures should be developed and implemented to help the spread of existing innovations to a broader range of firms.

13.5 Encouragement should be given to firms to adopt 'continuous improvement' methods to embed incremental innovation, as this will generate large productivity improvements quickly.

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

13.6 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 USA.

13.7 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.

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 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

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

Commonwealth government grants 2018 to 2022

The content below is an extract from the White Paper produced by the IPA Deakin SME Research Centre. It is the first in a series of reports on this topic. We are grateful to Prof George Tanewski for making an early copy of the paper available.

____

This report provides an extensive analysis of Australian Government grants awarded to businesses between 2018 and 2022. Each year, the government spends billions of dollars of taxpayers' money on grants to community organisations and businesses. Between 2018 and 2022, the government handed out an average of about $14 billion annually on 29,000 grants – with total expenditure of around $70 billion over the five years.

Approximately 9% of all Commonwealth grants – about 2,600 annually – were provided for business purposes from 2018 to 2022. Average annual expenditure on business grants was around $600 million, or more than $3 billion in total over the five years. Despite the significant expenditure involved, publicly available information about business grants, the selection processes for awarding them and the businesses that receive them is very limited.

The primary purpose of this research report is to illuminate and scrutinise this hitherto shrouded process. Using data from the government's online GrantConnect platform, we have analysed in detail the various selection processes, the types of grants awarded, and the quantum of financial support provided. A key element of our analysis involved constructing an index to rate the various processes for awarding business grants. For each type of grant, we separately rated the openness of the applicant pool and the competitiveness of the selection process. The collective results, outlined below, provide considerable cause for concern.

Inherent problems with the grants system were highlighted in 2021 in a scathing review by the Australian National Audit Office (ANAO). Yet, more than two years since the ANAO review, our research into business grants reveals that the administration of this perpetual multi-billion-dollar pipeline of Commonwealth public expenditure remains, to a significant degree, shielded from public scrutiny – and mostly without competitive selection processes for grant applicants. These issues raise questions about the integrity of a system that has already been tarnished by high-profile political controversies – including the so-called 'sports rorts' affair – and leaves the system potentially open to ongoing misappropriation or misallocation of public money.

Our research reveals a large majority of business grants – in defiance of government guidelines – are awarded through non-competitive processes. We found:

The overwhelming majority (83.77%) of business grants between 2018 and 2022 were awarded on a demand basis; that is, business applicants that met stated eligibility criteria were awarded grants up to the limit of available funding – without any assessment of their merits relative to other applicants, nor reciprocal obligation to taxpayers.

The skewing towards non-competitive processes was far greater for business grants than for general community grants. A Joint Committee of Public Accounts and Audit inquiry into Commonwealth grants (2023) found that just 35% of grants across all categories were subject to competitive selection processes. By itself, this was considered cause for concern. Our research reveals much worse numbers for business grants awarded from 2018 to 2022, with fewer than 17% subjected to competition between applicants.

Competitive selection processes were rare for all categories of business grants. Based on our index (COM) ratings, competitive processes were particularly scarce for ‘business development’ grants (average competitiveness score of 0.15), ‘small business’ grants (0.04) and ‘industry innovation’ grants (0.09).

For small businesses, grants offered via ad hoc (ministerial discretion) and closed, non-competitive processes had higher average values (approximately $1.7 million for both) than grants subject to open, competitive processes ($1.5 million).

A significant minority of grant processes, involving large sums of public money, remain almost entirely hidden from public scrutiny. Most notable among them are ad hoc grants, which are awarded by ministerial discretion, and which therefore arguably entail the greatest scope for misuse of public resources.

A total of 313 ad hoc grants were awarded by government ministers for the purposes of small businesses between 2018 and 2022. These grants had a mean value of $1.7 million and a total value of about $540 million. Despite the sizeable numbers involved, ministers exercised this discretion with negligible oversight.

The preponderance of non-competitive processes for awarding business grants appears in conflict with the Commonwealth Grants Rules and Guidelines (CGRG) which, as the ANAO noted in its 2021 review, urge open and competitive merit-based processes.

In contrast to our findings on the paucity of competitive business grant selection processes, we found a high proportion of processes were open (defined for this study as open to any applicants that meet the stated eligibility criteria, and publicly advertised) across most categories. Among more open categories were grants for ‘business development’ (average score 0.84), ‘small business’ (0.99) and ‘industry innovation’ (0.99).

However, while open processes involve, by definition, at least some level of transparency, we found a broad and systemic lack of transparency across most Commonwealth grants programs – both open and closed. For example, the online GrantConnect platform – the primary source of public information on Commonwealth grants – provides only headline or summary information on grants, grant programs and recipients. And for competitive grant processes, there is no information on numbers of applicants, nor the criteria used to separate them. Moreover, the identities of competitive grant applicants remain undisclosed throughout selection processes – and only successful applicants are ever publicly identified.

Among the multiple government agencies that awarded business grants from 2018 to 2022, only a few operated grant programs with high levels of both competitiveness and openness. They included the Great Barrier Reef Marine Park Authority (scores of 1.0 and 1.0) and the National Emergency Management Agency (0.98 and 0.98).

Other agencies – including Wine Australia and Austrade – used mostly open processes, but rarely assessed applicants on a competitive basis.

We believe this report raises serious questions about the transparency, accountability and integrity of significant components of a system that hands out almost $1 billion of taxpayers’ money annually to Australian companies – from the very small to the large – with virtually ‘no strings attached’.

Accordingly, we have prepared four recommendations aimed at improving the transparency and competitiveness of the business grants system and, by extension, its integrity.

15. Recommendations

While administering a broad system of government grants for both the community and business is a complex and nuanced undertaking, addressing the many concerns regarding transparency and accountability of the system is likely to improve perceptions of fairness, equity and efficiency held by the public. It is through this lens that we formulated our recommendations.

In providing the recommendations, we recognise the important overlapping legal regimes that govern documentation, recording and disclosure of grant information – most significantly, the CGRG (2017). These regulations provide guidance to ministers on the required standard for all aspects of grants administration. These regulations interact with the *Privacy Act 1998*, which restricts the nature of information that can be released by Government. Where applicable, the following recommendations may require changes to these requirements and regulations.

15.1 Enhance transparency by publicly identifying all applicants for competitive grants, both successful and unsuccessful.

The primary purpose of releasing administrative data on grants and grant provision is to allow monitoring of the processes by the public. As previously discussed, the administration of grant provision "regularly falls short of expectations" and is not fully consistent with the intent of compliance requirements in the CGRG (ANAO, 2022).

While the ANAO regularly conducts reviews of grant provision, our research suggests more information about the administration of individual grants needs to be provided for the public to have confidence in the system. According to the CGRG, grants administration must be consistent with the seven key principles, including governance and accountability (principle 6) and probity and transparency (principle 7). In this context, we believe the present information set provided by the government, and available on GrantConnect, does not allow for proper scrutiny of most of these aspects of administration. The dataset contains only headline or summary information on grants (or grant programs) and recipients of grants. For competitive grants, no information is provided on key areas such as: total number of applicants; number of successful applicants; number of unsuccessful applicants; and number of applicants that did not meet the eligibility criteria. Nor is there any information on the decisive criteria used to separate applicants.

To enhance the transparency of the grant administration process, we recommend that the government expand its disclosure on GrantConnect to include the clear identification of all applicants for all competitive grants, and the specific criteria used to separate them. In making this recommendation, we accept there may be some privacy concerns for applicants. However, we believe the implications for privacy are minimal, and that these concerns are outweighed by the need for more transparency. Applicants currently maintain anonymity throughout the process but must accept eventual disclosure of their identity in the event of a successful application, even for small grants. Accordingly, the value of privacy appears temporary at most. From a public policy perspective, there is a strong case to be made that allowing private corporations, individuals, or organisations to request government funding anonymously substantially weakens trust in the grants processes. As other countries such as the UK, France, Sweden, and the US currently have similar disclosure rules on grants to Australia's, introducing mandatory disclosure of applicant details would be a novel step forward, with Australia signalling a strong commitment to government transparency and trust.

To mitigate any material privacy concerns for applicants, different approaches to identity disclosures could be used. For example, the disclosure of applicant data could relate solely to corporate entities and other institutions, removing concerns about disclosure of personal individual information. We also propose that certain types of grants may have confidentiality applied to them – specifically,

those related to defence or national security issues. This would be consistent with existing practice to keep certain details of some grants withheld for specific confidentiality reasons.

Overall, however, we caution against providing grant information in any anonymised form, or without material details of the purpose or activities related to the application. When the identity of applicants and details of their applications are withheld, the ability of the public to satisfy itself of the probity of grant administration is heavily impaired.

15.2 Full and prompt disclosure should be required when government ministers overrule public service or expert committee recommendations on awarding of grants.

Ministerial power is a primary concern with the administration of grants. Despite a potentially extensive application and evaluation process, ministers in the relevant public offices retain discretion over the success of grant applications and can order the provision of grants on bases other than merit. Two recent scandals clearly illustrate problems with ministers holding the power to override recommendations for meritorious grants. In 2021, then acting Federal Education Minister Stuart Robert vetoed six research grants against the recommendations of the Australian Research Council. In the Australian Financial Review, John Roskam of the Institute of Public Affairs described this action in the following terms: "The idea of a political veto, a ministerial veto, a government veto on university research is, at one level reprehensible… [and] It runs counter to a liberal democracy".4 Similar concerns were expressed in relation to the colloquially known "sports rorts scandal" of 2019, where the ANAO found in its report into the Community Sport Infrastructure Program Award of Funding under the Community Sport Infrastructure Program that many grants were awarded on criteria other than merit. Criticisms of ministerial override centre on the insertion of politics into decision making, which undermines the efficiency and effectiveness of a system that is supposed to award grants based on merit, and instead awards grants based on political expediency and the ability of the grants to influence votes in marginal or safe seats. Many other types of events and grants have also generated concern over the use of ministerial discretion.5

While critics suggest that wielding discretionary power over government funding may be undemocratic, it is not necessarily inconsistent with a proper functioning democracy or an efficient administration of grants. Ministers are elected officials and, accordingly, are subject to monitoring by the public, who express their judgement at elections. Conversely, public servants or panels that may otherwise make decisions on the merits of grant applications are seldom publicly elected. Accordingly, resting discretionary powers with ministers may be preferable, from a democratic perspective, as the public can hold ministers accountable through the election process.

However, for the democratic process to serve as a control on misuse of public funds, there must be full and clear disclosure by ministers when they use discretion. At present, ministers exercising such discretion are required to write to the Minister of Finance by 31 March each year reporting, collectively, the use of discretion and the reasons for use (para 4.11 CCRG). However, to enhance the

---

[4] https://www.afr.com/policy/health-and-education/robert-s-research-grants-veto-a-pre-election-dog-whistle-20220105-p59lzm.

[5] See e.g. https://australiainstitute.org.au/report/grants-with-ministerial-discretion/; https://www.theage.com.au/politics/victoria/ex-ministers-kairouz-and-scott-face-scrutiny-over-grant-funding-20211207-p59fdh.html.

public's ability to monitor the use of ministerial discretion, we call for regulations that require ministers to fully disclose their use of discretion for each grant for which discretion is exercised, at the time the grant is provided. Similar calls have been made in NSW by the Auditor-General which,

in relation to the investigation into the Regional Cultural Fund, asserts that any use of ministerial override should be documented.6

Currently, several requirements exist regarding record keeping (see Chapter 2 of Report 495 Inquiry into Commonwealth grants administration),7 but none exist for contemporaneous disclosure of discretion. We recommend that regulations require ministers to disclose their use of discretion; explain the alternatives recommended by the public service or panel; and explain their reasons for exercising discretion. Ministers should report these items in writing on GrantConnect and have them incorporated into the GrantConnect data. As with existing disclosures on GrantConnect, this should occur within 21 calendar days of the grant agreement taking effect.

15.3 Toughen disclosure requirements for ad-hoc grants awarded by government ministers.

Government grants are provided through a variety of application processes, some of which are less competitive than others, and therefore create greater scope for misuse of government resources. As discussed in Section 2, open competitive processes place no (or few) restrictions on the number (or type) of organisations or individuals that may apply for a grant. The applicants are assessed competitively, and the recipients are determined on merit according to several selection criteria. In contrast, non-competitive arrangements choose grant recipients without relative assessment of the applications to a closed pool of applications.

Ad hoc grants entail arguably the greatest scope for misuse of resources as the regular administration of grant processes is suspended and replaced with an exercise of ministerial discretion. From our data, a total of 21,078 ad hoc grants were awarded between 2018 and 2022, of which 386, or 2.88% of all grants, were business grants. These ad hoc business grants had a mean value of $1.6 million, and total value in excess of $610 million across the sample period. Yet despite the sizeable value of the grants, ministers exercise this discretion with negligible oversight. According to the Department of Finance, ad hoc grants "generally do not involve planned selection processes, but are instead designed to meet a specific need, often due to an urgent matter or other circumstances".8 There is no requirement for ad hoc grants to be publicly advertised on GrantConnect, nor any requirement for ministers to publicly explain their use of discretion to award grants. However, as with other grants, ministers are required to record in writing the basis for the approval of the grant, and the grants must be administered consistently with the seven key principles.

Whether all ad hoc grants meet the "urgent matter or other circumstances" criterion is unclear. For example, across a three-year period, one private company received approximately $26.5 million to assist in a business conversion, and another received around $17 million in grants to develop steel production facilities. Similarly, a clean energy company received $5.5 million to develop home charging infrastructure. A broader examination of non-business grants suggests a range of similarly

[6] https://www.audit.nsw.gov.au/our-work/reports/integrity-of-grant-program-administration.
[7]https://parlinfo.aph.gov.au/parlInfo/download/committees/reportjnt/RB000137/toc_pdf/Report495InquiryintoCommonwealthgrantsadministration.pdf.
[8] See template and surrounding CCGR available at: https://www.finance.gov.au/government/commonwealth-grants/tools-and-templates.

intriguing grants, including grants for market stalls and similar events, art installations and rebranding of government entities.

This report passes no judgement on whether these grants are valuable additions to the community and to the broader Australian public. Perhaps many of these grants have resulted in highly positive outcomes. Rather, we question whether grants of this sort should be provided without either a competitive process, where the merits of the grant are assessed relative to other potentially

meritorious applications, or disclosure of the use of ministerial discretion in a format and location that invites the public to understand the use and reasoning for the minister's discretionary application of public funds.

Consistent with Recommendation 15.2, we call for an enhanced regime of disclosure related to ad hoc grants. As before, we recommend that regulations be amended requiring ministers to:

- disclose their use of discretion
- explain the alternatives recommended by the public service or panel
- explain their reasons for exercising discretion.

Ministers should report these items in a written disclosure released on GrantConnect and incorporated into the permanent GrantConnect data. As with existing disclosures on GrantConnect, this disclosure should occur within 21 calendar days after the grant agreement takes effect. While this does not, in any way, reduce the ability for ministers to use their discretion, it does provide a means for the public to monitor the use of discretionary grants.

15.4 Require government agencies to provide more information about grants and their purposes.

For the public to meaningfully consider and scrutinise the delivery of grants by government, public information must adequately describe the reasons for awarding the grant and/or the purpose for which the grant will be used. As discussed in Section 2, it is important that the purpose of the grant is well explained to avoid moral hazard and/or adverse selection and to establish the level of additionality that these grants might provide to the business community. While preceding recommendations focus on ensuring the use of ministerial discretion is accompanied by suitable disclosures, proper administration of grant processes should also ensure that the public can scrutinise grants provided without ministerial discretion.

For grants awarded to private organisations, GrantConnect provides information on the actions that will be taken with the funding, on activities to which those actions relate, and the nature of the grant program. The most relevant item is the 'purpose' for which the grant is to be used, which is detailed in a discrete text field. For example:

"A grant has been awarded to build an innovative solution to address information sharing challenges across jurisdictions for occupational registrations and licenses. The project will use the Spectar Group SpecIA platform to automate the information matching requirements. Armed with advanced intelligence and limitless automation-processing capabilities, SpecIA platform is capable of taking on large-volume of repetitive tasks based on business and validation rules. The grant will enable Spectar Group to stand up a test instance to demonstrate the feasibility of SpecIA platform to automate the registration and license information sharing process with minimal user intervention." (GA226371)

There is, however, considerable variation in the quality of statements of purpose provided through GrantConnect. Details on many grants provide only minimal disclosure of intended purpose. For example: "Business growth grant" (GA64061, Demand-driven); "Support package assisting small

exporters (GA122164, Open Competitive); and “Support SFSE - NABS - Community Engagement” (GA44610, Ad-Hoc). These examples are typical of many grant details provided on GrantConnect and are drawn from different processes. For the business grants covered in our data set, more than 54% provided fewer than 20 words to describe the purpose, and more than 75% fewer than 30 words. Further analysis is presented [in the full white paper].9 As shown, purpose descriptions become even less extensive for ad hoc grants, with fewer than 10 words covering the purpose in more than 50% of ad hoc grants, and fewer than five words in half of those. Similarly, among closed and non-competitive business grants, more than 20% provide fewer than 10 words of description. The most substantial descriptions, perhaps unsurprisingly, involved grants provided on an open and competitive basis, with over 75% containing more than 40 words.

While it may be plausible that minimal disclosure in some cases is already optimal, and that the use of boilerplate language and undetailed descriptions of purpose fits with the nature of each grant (for example, short descriptions may be appropriate where the purpose of the grant for the recipient is evident from the nature of the grant program itself), an examination of the data available to the public does not necessarily support such a conclusion. Accordingly, we recommend that the government assess the requirements of the CGRG for disclosure of purpose on GrantConnect, and enhance the required disclosures, especially for ad hoc, demand driven and targeted/restrictive grants. The guidelines should stop the use of boilerplate language and require disclosure of specific purposes where the specific purpose is not apparent from the nature of the grant and requires more full disclosure of purpose commensurate with what is currently evident for open and competitive grants.

End

[9] The computed length of descriptions of purpose presented in [Figure 4] does not adjust for a variety of institutional factors that may contribute to the length of the description. Such factors could include the agency that issues the grant. In unpresented analyses, adjusting for data for agency specific factors does not alter the conclusion draw nor significantly reduce the amount of variation between selection processes.