JANUARY 2025

Pre-Budget **Submission**

2025-26

Contents

Introduction

The Institute of Public Accountants (IPA) Group welcomes the opportunity to present our pre-Budget submission for the 2025-26 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.

Major reform cannot always be achieved in a short timeframe. We are disappointed 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 the business community. Holistic tax reform (including the GST) is essential to our future prosperity. 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.

The recommendations made in this submission are supported by research conducted by the IPA Deakin SME Research Centre. This is a partnership between Deakin University and the IPA that focuses on issues that support the overall SME ecosystem. The Centre's expertise in the three pillars of productivity – investment, innovation and human capital — allows them to broadly examine issues related to regulation, trade and sustainability of SMEs, including the well-being, resilience and skills of SME owners.

The Centre has published several white papers covering SME innovation, competition, and participation; innovation policy; and Commonwealth Government Grants. These can be accessed via the IPA website.

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

[signed]

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

Recommendations

Establishing a Small Business Administration (SBA) style small business government agency similar to that in the USA.

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

Regulatory burden overload

- The Government apply a 'risk-based' approach to regulation, so individuals and entities that are at a 'low risk' of non-compliance are not subjected to inappropriate and unnecessary regulatory scrutiny. The EU style 'small first' approach should be adopted.
- The Government contribute to and be guided by the work of the OECD in enhancing global awareness of and applying good regulatory practice.
- The Government conduct meaningful and genuine periodic reviews of regulatory agencies/bodies and statutory boards to ensure that public interest is well served. Despite numerous reviews, taskforces and so on, there is only minor improvement, if any, in the overall regulatory burden placed on small business and all business in general.
- The Government ensure that the Office of Impact Analysis is adequately resourced to undertake genuine evidence-based cost-benefit analysis, and that its work should not be impacted by political imperative.
- The Government 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.

Innovation policy – it's time to get serious

- More support be provided for R&D by small and medium-sized firms.
- Better linkages be developed between cutting-edge research universities and industry. Typically, only large firms have the resources to fund university-level research and development.
- More support be provided for firms to adapt existing technologies and innovation.
- Measures be developed and implemented to help the spread of existing innovations to a broader range of firms.
- Encouragement be given to firms to adopt 'continuous improvement' methods to embed incremental innovation, as this will generate large productivity improvements quickly.
- Government procurement initiatives be further developed 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.
- A pool of funds for be allocated for further research into youth entrepreneurship in Australia, so policy decisions made in this area are based on research evidence.

Taxation reform – time to act

- The Government commit to sensible, well considered, wholesale structural reform of Australia's taxation system.

Payday Super and Superannuation Guarantee penalty regime

- The proposed start date of 1 July 2026 should be deferred to a later year, at a date decided in consultation with employer communities and the digital service providers, to allow all SG ecosystem shortcomings to be addressed.
- Employers be given 7 days to make SG contributions to employees' superannuation accounts exclusive of the time it takes for funds to respond or match a contribution to a fund member
- Introduce an automated onboarding form that imports stapled fund or choice fund elections from the ATO directly into an employer's payroll system.
- A fairer and proportionate penalty regime must be introduced to differentiate between infrequent late paying employers and deliberate non-paying employers.

Retain deductibility of GIC and SIC

- Retain the deductibility of the GIC and SIC by amending the Treasury Laws Amendment (Tax Incentives and Integrity) Bill 2024 to remove Schedule 2.
- Address the non-payment of tax debts by:
    - Lowering the business tax disclosure threshold; or
    - Increasing the uplift percentages

Permanent increase in the SBE instant asset write-off threshold

- The instant asset write-off threshold be permanently increased to $30,000 with effect from 2024-25.

Reinstating the small business technology boost and small business energy incentive

- We recommend that both the small business technology boost and the small business energy incentive are reinstated.

Proposed Division 296 tax

- The proposed Division 296 measure does not proceed. At a minimum, amendments are made so that:
    - only capital gains which have been realised are subject to taxation; and
    - the threshold be subject to periodic indexation.

Non-arm's length expense rules for specific expenses

- ITAA 1997 be amended such that the amount of NALI that arises in respect of an asset in relation to which a non-arm's length specific expense has been incurred is capped at an amount that is proportionate to the mischief and which broadly mirrors the treatment of non-arm's length general expenses.

Tax Advisory Board – enhancing accountability and governance

- An Australian Tax System Advisory Board be created as recommended by the Henry Tax Review.

Reform of individual residency rules

- The Government proceed with 'Modernising individual tax residency' in line with the Board of Taxation recommendations

Reform of corporate tax residency rules

- The Government announce whether it intends to proceed with the 2020-21 Budget measure.
- The definition of residency for corporate tax entities should be reformed to remove ambiguity and provide certainty for foreign incorporated corporate taxpayers.

Taxation of trusts

- A review of the taxation of trusts be conducted as a priority
- S100A of the ITAA 1936 amended to provide more certainty around what mischief it is targeting, particularly in regard to its application around family trusts.

Division 7A: reduce uncertainty around future changes

- Further consultation be undertaken to revisit ways to minimise the operation of Division 7A to businesses that use corporate profits to fund business activities.

Black Economy Taskforce

- Continue the prioritisation of the outstanding recommendations of the Black Economy Taskforce to maintain momentum in the reform agenda.

Fringe Benefits Tax

- The FBT system is reviewed and reformed as a matter of urgency.

Reform small business CGT concessions

- Increase eligibility by increasing the turnover threshold from $2 million to $10 million.
- Remove the net asset value test and replace the 15-year exemption, active asset reduction and retirement exemption with one CGT exemption subject to a cap.

Expand deductibility rules around education

- 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 but is intended to lead to a different income-earning avenue.
- The small business skills and training boost is reinstated to encourage employers to invest in upskilling their existing employees.

Small Business Tax Offset

- Increase the cap for the unincorporated tax discount to make it a meaningful incentive and apply the tax discount on a ‘per business’ basis.

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

- As part of the government’s Strategic Examination of Research and Development, review the effectiveness of the R&D tax incentive in supporting and improving the innovation capabilities of SMEs.

Commonwealth Government grants

- The government review and reform the business grants system to improve the transparency, competitiveness, and effectiveness of grants programs and schemes.

Small business: big vision

Productivity matters. Productivity growth is the primary determinant of economic 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.

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 taking a deeper dive into innovation policy. Published White Papers can be accessed via the IPA website.

Government has an important role to play in positively influencing productivity growth and supporting small business by:

- 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 small business advisory council to provide direct policy input and options to government regarding the points above
- Establishing a central, 'one-stop-shop' government agency for small businesses, similar to the US Small Business Administration (see below).

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

Establishing an SBA style small business government agency

RECOMMENDATION

1. The Government establish an SBA style agency as a one-stop-shop for small business and SMEs.

Establishing an Australian national small business agency similar to the US Small Business Administration (SBA) agency (Small Business Administration) would support the growth and sustainability of the nation's economically vital small and medium-size enterprises (SME) sector.

Created in 1953, the US SBA agency helps 'small business owners and entrepreneurs pursue the American dream'. It is 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. 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'.

A 'one-stop shop' agency modeled on the SBA could potentially improve productivity by providing a range of support services tailored to small business, such as the following, from a single central source.

- Access to capital
- Business development support
- Access to markets
- Technology and innovation support
- Regulatory assistance
- Disaster recovery.

A more detailed analysis is provided in the IPA Deakin SME Research Centre white paper *The Case for a National Australian Small Business Agency*.

A range of Australian agencies undertake many of these functions, although perhaps not as extensively and not in one place. Despite the support provided by agencies such as the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) and the state based small business commissioners, there is still confusion and complexity in the Australian system.

Bringing these functions and resources into one agency would be of benefit to small business and consumers, making it significantly easier to navigate the plethora of government support.

Regulatory burden overload

RECOMMENDATIONS

2. The Government apply a 'risk-based' approach to 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.
3. The Government contribute to and be guided by the work of the OECD in enhancing global awareness of and applying good regulatory practice.
4. The Government 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.
5. The Government 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.
6. The Government 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.

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.

Innovation policy – it's time to get serious

RECOMMENDATIONS

7. More support be provided for R&D by small and medium-sized firms.

8. Better linkages be developed between cutting-edge research universities and industry. Typically, only large firms have the resources to fund university-level research and development.

9. More support be provided for firms to adapt existing technologies and innovation.

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

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

12. Government procurement initiatives be further developed 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. A pool of funds for be allocated for further research into youth entrepreneurship in Australia, so policy decisions made in this area are based on research evidence.

The IPA urges the Government to commit to a progressive innovation policy. We refer to the findings and recommendations of the IPA Deakin SME Research Centre white paper, *Post Covid Policy Options to Enhance Australia's Innovation Capabilities*, which are still relevant.

The IPA's concerns relating to innovation policy are supported by the findings of the Productivity Commission inquiry, *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.*

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[1], 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.

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

Taxation reform – time to act

RECOMMENDATION

14. The Government commit to sensible, well considered, wholesale structural reform of Australia's taxation system.

Tax 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.

Tax reform has been a key part of successive government's policy agenda to create a tax system that supports higher economic growth and living standards, improves international competitiveness and adjusts to a changing economy, yet there has been little progress to achieve these stated aims.

The final report of Henry Review into taxation was released in 2010 followed by the *Rethink* paper on tax reform in 2015. Despite these efforts, we have not seen movement on fundamental tax reform, instead we have experienced a piecemeal approach to tax policy. Simply tinkering at the edges to create 'stop gap' solutions will not address the need for fundamental reform. The tax system was already failing to address a changing pre-COVID-19 economy and was seen as holding Australia back in fulfilling its economic potential. It represents one of many important levers that the Government has at its disposal to reinvigorate a much-needed growth agenda.

There has been little progress to achieve these stated aims. In recent years, only a few significant tax and superannuation reforms have passed Parliament, most notably the structural changes to individual tax brackets and rates and the multinational tax package. Most other enacted measures represent tinkering at the edges.

As examples, there has been no attempt to fundamentally improve the longstanding problem areas of the taxation of trusts and Division 7A. There has been no legislative action in relation to a much-needed simplification and clarification of individual tax residency rules, despite the initial announcement in the 2021-22 Federal Budget and a consultation paper being released in September 2023. Successive Governments have not enacted the Board of Taxation's key recommendation in relation to corporate tax residency reform which was adopted in the 2020-21 Federal Budget. Various measures to encourage business investment in assets, technological developments and human capital have generally only been temporary (acknowledging that the Future Made in Australia plan proposes some permanent initiatives and incentives, although they are yet to be legislated).

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, the NDIS, interest servicing costs on debt and transitioning to a green economy will present fiscal challenges in the years ahead. The 2023 *Intergenerational Report* highlights these pressures on our fiscal sustainability.

Pre-COVID, Australia was 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 introduced 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 per cent over a period that includes the dot.com recession, the global financial crisis (GFC) and now the coronavirus recession.

With a significant increase in debt, uncertainty around the long run fiscal sustainability, and the high reliance on personal and company tax at the Commonwealth level and property transactions at the State level, our tax system is ill-equipped to manage the economic challenges ahead.

Around 60 per cent 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 the Parliamentary Budget Office projects that personal income tax revenue will increase from 12.2 per cent of GDP (at an average rate of 26.1 per cent) in 2023-24 to 14 per cent (at an average rate of 28.2 per cent) in 2034-35, largely due to bracket creep. This represents a disproportionate burden on personal taxpayers in the years ahead unless corrective action is taken, and the tax base is broadened.

The spike in prices in key export commodities in recent years has provided a temporary lift in company receipts from mining related activities. This situation will reverse at some point as commodity prices have begun to decline and will 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 per cent 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: that is 'equity' 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
- 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 per cent of total tax revenue collected by Australian Governments, was derived from only 10 of the 125 taxes paid by Australians each year. Conversely, 10 per cent 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. It is 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 the interim before wholesale reform of the taxation system occurs, we make the following recommendations relating to key areas within the existing tax system that require immediate attention.

Tax recommendations

Payday Super and Superannuation Guarantee penalty regime

15. The proposed start date of 1 July 2026 should be deferred to a later year, at a date decided in consultation with employer communities and the digital service providers, to allow all SG ecosystem shortcomings to be addressed.

16. Employers be given 7 days to make SG contributions to employees' superannuation accounts exclusive of the time it takes for funds to respond or match a contribution to a fund member

17. Introduce an automated onboarding form that imports stapled fund or choice fund elections from the ATO directly into an employer's payroll system.

18. . A fairer and proportionate penalty regime must be introduced to differentiate between infrequent late paying employers and deliberate non-paying employers.

Retain deductibility of GIC and SIC

19. Retain the deductibility of the GIC and SIC by amending the Treasury Laws Amendment (Tax Incentives and Integrity) Bill 2024 to remove Schedule 2.

20. Address the non-payment of tax debts by:

- Lowering the business tax disclosure threshold; or
- Increasing the uplift percentages

Permanent increase in the SBE instant asset write-off threshold

21. The instant asset write-off threshold be permanently increased to $30,000 with effect from 2024-25.

Reinstating the small business technology boost and small business energy incentive

22. We recommend that both the small business technology boost and the small business energy incentive are reinstated.

Proposed Division 296 tax

23. The proposed Division 296 measure does not proceed. At a minimum, amendments are made so that:

24. only capital gains which have been realised are subject to taxation; and

25. the threshold be subject to periodic indexation.

Non-arm's length expense rules for specific expenses

26. ITAA 1997 be amended such that the amount of NALI that arises in respect of an asset in relation to which a non-arm's length specific expense has been incurred is capped at an amount that is proportionate to the mischief and which broadly mirrors the treatment of non-arm's length general expenses.

Tax Advisory Board – enhancing accountability and governance

27. An Australian Tax System Advisory Board be created as recommended by the Henry Tax Review.

Reform of individual residency rules

28. The Government proceed with 'Modernising individual tax residency' in line with the Board of Taxation recommendations

Reform of corporate tax residency rules

29. The Government announce whether it intends to proceed with the 2020-21 Budget measure.

30. The definition of residency for corporate tax entities should be reformed to remove ambiguity and provide certainty for foreign incorporated corporate taxpayers.

Taxation of trusts

31. A review of the taxation of trusts be conducted as a priority

32. S100A of the ITAA 1936 amended to provide more certainty around what mischief it is targeting, particularly in regard to its application around family trusts.

Division 7A: reduce uncertainty around future changes

33. Further consultation be undertaken to revisit ways to minimise the operation of Division 7A to businesses that use corporate profits to fund business activities.

Black Economy Taskforce

34. Continue the prioritisation of the outstanding recommendations of the Black Economy Taskforce to maintain momentum in the reform agenda.

Fringe Benefits Tax

35. The FBT system is reviewed and reformed as a matter of urgency.

Reform small business CGT concessions

36. Increase eligibility by increasing the turnover threshold from $2 million to $10 million.

37. Remove the net asset value test and replace the 15-year exemption, active asset reduction and retirement exemption with one CGT exemption subject to a cap.

Expand deductibility rules around education

38. 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 but is intended to lead to a different income-earning avenue.

39. The small business skills and training boost is reinstated to encourage employers to invest in upskilling their existing employees.

Small Business Tax Offset

40. Increase the cap for the unincorporated tax discount to make it a meaningful incentive and apply the tax discount on a ‘per business’ basis.

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

41. As part of the government’s Strategic Examination of Research and Development, review the effectiveness of the R&D tax incentive in supporting and improving the innovation capabilities of SMEs.

Further details of the tax related recommendations are contained in the *Tax Reform – time to act* policy paper which is provided with this submission and can also be found on the IPA website, Small Business White Paper.

Commonwealth Government grants

RECOMMENDATION

42. The government review and reform the business grants system to improve the transparency, competitiveness, and effectiveness of grants programs and schemes.

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 per cent 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 $834 million, or more than $4 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.

During 2024, the IPA Deakin SME Research Centre has produced two white papers in a series of reports on the operation of the Commonwealth grants schemes.

The first, *Commonwealth Government Grants 2018 to 2022*, provides transparency to an otherwise shrouded process analysing in detail the various selection processes, the types of grants awarded, and the quantum of financial support provided.

The second, *Efficacy of Australian Commonwealth Business Grants*, investigated the efficacy of business grants programs

Inherent problems with the grants system were highlighted in 2021 in a scathing review by the Australian National Audit Office (ANAO). However, more than three years after the ANAO review, our research into business grants revealed that the administration of this perpetual multi-billion-dollar pipeline of Commonwealth public expenditure remained, 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.

The research revealed a large majority of business grants – in defiance of government guidelines – are awarded through non-competitive processes.

- The overwhelming majority (83.77 per cent) 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 per cent 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 per cent 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 the findings on the paucity of competitive business grant selection processes, 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', 'small business' and 'industry innovation'.

However, while open processes involve, by definition, at least some level of transparency, a broad and systemic lack of transparency was found across most Commonwealth grants programs – both open and closed.

Further, when considering the effectiveness of the grants awarded, the second white paper demonstrated that more than 30 per cent of nearly $4.2 billion in Australian Commonwealth business grants awarded between 2018 and 2022 failed to generate any significant business or economic benefits, wasting billions of Australian taxpayer dollars.

The study found that financial grants failed to improve business performance, productivity, sales, turnover, or efficiency. In some instances, the study found that these grants actually had a negative impact on business performance.

Of particular concern, 63 per cent of recipients that received multiple grants had low efficiency and productivity, suggesting that grants were being used to sustain underperforming businesses.

Other key findings from the second white paper include:

- Grants had the strongest impact on employment in micro and small businesses (3.63% increase) compared to large companies (2.96 per cent increase).
- Grants had the strongest impact on financial performance in large companies (4.96% increase in return on assets), with non-significant effects for medium, small and micro businesses.
- Older businesses (10+ years) benefited more from grants than younger businesses, increasing financial performance by an average 3.46%, compared to startups (2.73%), young (2.59%) and mature (1.89%) businesses.
- Grants had the highest average employment benefit for startups (5.10%) and young businesses (3.80%), followed by mature (2.08%) and older (1.30%) businesses.
- Industry Innovation grants were associated with significant financial performance benefits for large businesses (9.53%), along with single-digit percentage increases in full-time employee numbers, turnover and human capital efficiency across businesses of various sizes and age.

- Small business grants were associated with significant increases in full-time employment for micro and small businesses (8.15%) and increases in sales turnover for startups (5.84%) and young (7.82%) businesses.
- Business grants only significantly improved full-time employment (6.70%) in recipient firms when both open and competitive selection procedures were used.
- Grants awarded under open and competitive selection procedures typically yielded little, if any, benefit in business performance, sales turnover and efficiency. Open selection processes, where applicants did not have to compete for grants, were associated with even worse outcomes, including declines in financial performance (-4.87%) and sales turnover (-6.57%).

Serious questions remain regarding the transparency, accountability, effectiveness, 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'.

The white papers make a total of nine recommendations aimed at improving the transparency, competitiveness, and effectiveness of the business grants system.

- Enhance transparency by publicly identifying all applicants for competitive grants, both successful and unsuccessful.
- Full and prompt disclosure should be required when government ministers overrule public service or expert committee recommendations on awarding grants.
- Toughen disclosure requirements for ad-hoc grants awarded by government ministers.
- Require government agencies to provide more information about grants and their purposes.
- Review and overhaul business grant selection processes to make them merit-based.
- Clearly identify criteria and benchmarks for success in grant programs.
- Conduct impact evaluations on each grant program.
- Require grant recipients to publicly report on the success (or otherwise) of their business grant.
- Review and assess the effects of providing multiple grants to single recipients, to ensure taxpayer funds are not being wasted on 'subsidy-dependent' businesses.