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SMALL BUSINESS AND INCOME TAX:  
A WESTERN AUSTRALIAN SURVEY

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## 1. INTRODUCTION

*“Small business people value highly the opportunity to create, own and operate a business and thereby achieve economic independence. The small business sector provides a productive outlet for their entrepreneurial energies. Small firms play a major role in activities in which the success of the enterprise depends to an important degree upon personal skills....”*<sup>1</sup>:

Small business plays an important role in the Australian economy. According to one report<sup>2</sup> there are 750,000 small businesses in Australia which account for 96% of all firms, half of the private sector employment and a third of all employment in Australia. The Federal Government has estimated that small business generates some 57% of Australia's Gross Domestic Product.<sup>3</sup>

Small business is burdened, as are all businesses, with multitudinous regulatory mechanisms in areas such as workers compensation, health regulations, superannuation, training, occupational health and safety, industrial relations, copyright restrictions and taxation in all its guises. Taxation obligations can be subdivided into sales tax, fringe benefits tax, pay as you earn (PAYE), prescribed payments, child support, tax file number, Higher Education Contribution Scheme as well as personal income tax obligations.

The Beddall Enquiry<sup>4</sup> noted that taxation was the area of government regulation which was of greatest concern to small business during the enquiry, the most pervasive and important complaint being “the rapid growth in the size and complexity of taxation law, the complex and often apparently uncoordinated administrative systems that support it, and the associated compliance and reporting costs which are particularly onerous for small business.”

In a survey reported in the Bureau of Industry Economics' 1985 Small Business Review<sup>5</sup> the problems listed most frequently by firms were:

- government regulations (24% of respondents);
- taxation, tariffs and duties (22%);
- liquidity, access to finance and interest rates (18%); and
- lack of skilled staff (16%)

By virtue of its very nature, however, the small business sector is hampered by a lack of skill and expertise, not least of all in the area of knowledge of taxation obligations. And indeed, particularly in the retail sector, many small business operators have no desire to achieve expansion or even greater efficiency, being satisfied with traditional

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<sup>1</sup> B.L. Johns; W.C. Dunlop and W.J. Shehan “Small Business in Australia: Problems and Prospects” George Allen & Unwin Australia Pty Ltd; Sydney, 183.

<sup>2</sup> “Small Business in Australia - Challenges, Problems and Opportunities :Recommendations and Main Conclusions” Standing Committee on Industry Science and Technology AGPS January 1990 (The Beddall Enquiry)

<sup>3</sup> Guy McKenna “Small Business: Valuable Role in Recovery” The Australian Financial Review Wednesday June 10, 1992.

<sup>4</sup> *supra* note 2

<sup>5</sup> specifically the Small Business Survey conducted by Scott Holmes of Australian National University, Printed by AGPS 1985 pp 40 - 63.

methods of operation having achieved the goal of economic independence. It could be that this is one sector of the taxpaying community for which there are few appropriate mechanisms to lighten their compliance burdens.

The purpose of this study is to evaluate small business awareness of and attitudes to income tax, and particularly income tax administration.

In July 1994, Reark Research was commissioned to conduct telephone interviews, process the results and produce statistical tables as output. In September 1994 following administration of the survey, Reark was then commissioned to conduct the statistical analysis.

## **2. OBJECTIVES**

The questionnaire was designed by the author with assistance from Reark Research<sup>6</sup> and covers the key research objectives:

- to measure small business awareness of support networks and materials available to assist with taxation queries; and
- to determine which types of businesses do not utilise the support channels and the key reasons why.

Other objectives were:

- to identify current attitudes of small business operators towards the Australian Taxation Office as a service provider;
- to measure the awareness and appreciation of small business of exposure to penalty tax; and
- to seek small business views generally on income tax for small business.

A copy of the survey instrument is contained in Appendix A.

## **3. METHODOLOGY**

The survey was of a representative sample of small businesses across all industry sectors and using the 1994 Perth Yellow Pages, a proportionately stratified sample of ASIC Category key industry groups was randomly selected. As a result of the stratification sampling, small sample sizes across most groups means that caution is required in interpreting results analysed by industry sector.

The survey was conducted in July/August as this was considered to be the time when most small business operators would have "tax on their mind" being so close to the end of the financial year. Given the anticipated low response rate if a postal instrument were to be used, and given the general lack of availability of small business proprietors for face to face interviews, it was decided to elicit the information by way of telephone interviews.

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<sup>6</sup> The author would also like to thank Jeff Pope (Curtin University), Ian Wallchutzky (University of Newcastle), and L. Sivright (Western Australian Small Business Development Corporation) for their helpful comments in relation to earlier drafts of the questionnaire.

A total of 302 telephone interviews were conducted on weekdays during business hours between July 18th and August 2nd 1994. Interviewers made up to three call-backs to each business before substituting another in the sample, and in this way sample bias was minimised.

Interviewers were asked to reassure potential respondents that the survey was being conducted by Curtin Business School and was in no way connected with the Australian Taxation Office (ATO). Responses were sought from the owner of the business.

By industry type the following is the sample taken:

Table 1: Respondents by Industry Type

ASIC Category	No. of Listings	%	No of Interviews
Retail	13,816	23	69
Finance/Property and Business Services	9,522	16	48
Manufacturing	9,208	16	48
Community Services	6,471	11	33
Recreation and Personal Services	6,343	11	33
Construction	5,841	10	30
Wholesale	4,973	8	24
Transport and Storage	1,724	3	9
Agriculture/Forestry/Fishing and Mining	1,380	2	6
Total	59,278	100	300

Analysed by the type of business structure the sample showed:

Table 2: Respondents by Type of Structure

Business Structure	Total %
Company	32.8
Partnership	29.1
Sole Trader	23.8
Trust	9.6
Non-profit organisation	4.0
Other	0.3
Refused	0.3

This compares with Australian Bureau of Statistics<sup>7</sup> data which shows that for Western Australia companies represent 34% of business structures, sole proprietors represent 17%, partnerships 28%, trusts 20% and other 1%. It would seem that the sample used for this survey is representative of the total based on legal structure.

<sup>7</sup> From the ABS Business Register (Cat. 1322.0 Profiles of Australian Business). This business register refers only to business units that employ wage and salary earners and includes all businesses not just small business, however approximately 93% of the businesses included are small business using employee numbers as the criteria for determining "small".

#### 4. RESPONDENT PROFILE

Respondents were asked to advise the level of gross sales/receipts of the business in the last accounting year, in order to gauge the size of the businesses in terms of turnover.

Table 3: Respondents by Level of Gross Receipts

Gross Sales/ Receipts \$	Total %
<50,000	15.9
50,001 - 100,000	10.9
100,001 - 200,000	11.6
200,001 - 500,000	12.9
500,001 - 1,000,000	11.6
1,000,001 - 2,000,000	5.0
>2,000,000	5.2
refused	15.6
don't know/ not trading	8.9

In addition, respondents were asked to provide an indication of the trend of gross income for the business over the period of ownership. Not surprisingly, most reported stability or a slight increase.

Table: 4: Respondents by Profit Trend

Trend of gross sales	Total %
increasing significantly	13.9
increasing slightly	34.8
stable	29.8
decreasing slightly	13.9
decreasing significantly	3.3
not applicable	0.7
refused/don't know	3.6

Small businesses are usually defined *inter alia*, in terms of the number of employees.

The Small Business Council defines small business as “any business which is not a public company, a subsidiary of a public company or an entity in which a public company has a controlling interest, and which in the non-manufacturing sector has less than 20 employees and in the manufacturing sector has less than 100 employees, or is a business in respect of which the owner makes all the critical decisions.”<sup>8</sup>

Respondents were asked to advise how many full time employees were engaged in the business including the owner/operator of the business.

<sup>8</sup> Small Business Council Secretariat “Small Business Council Procedures” July 1987 p.5

Table 5: Respondents by Number of Employees

Number of employees	Total %
<2	40.4
2 - 4	24.8
5 - 10	17.2
11 - 20	8.6
>20	7.9
not applicable	0.3
refused	0.7

Respondents were asked how long the business had been under the current ownership.

Table 6: Respondents by Age of Business

Number of years	Total %
less than one year	12.3
2 - 3 years	20.5
4 - 5 years	13.6
6 - 10 years	22.2
more than 10	30.5
not applicable	0.7
refused	0.3

The respondents were also asked whether the business was a family business. In 64.5% of cases the respondents advised that the business concerned was a family business and 34.4% advised that it was not. The remainder refused or did not know.

Respondents were also asked to advise the highest level of educational qualification achieved by the person responsible for the day to day tax matters of the business.

Table 7: Respondents by Educational Qualifications

Educational qualification	Total %
Primary school	0.7
1 - 3 years of secondary school	9.6
4 - 5 years of secondary school	28.8
Qualified tradesperson	13.2
Tertiary qualifications	34.4
Postgraduate qualifications	8.6
Refused	0.3

## 5. SURVEY RESULTS

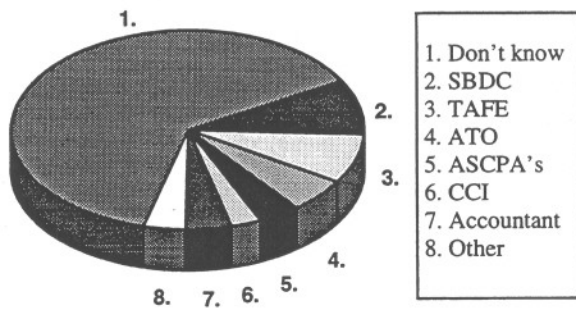
### 5.1. TRAINING IN TAXATION

The ATO is actively pursuing the goal of voluntary compliance through education and to this end has introduced a new education service specifically targeting small business. The TaxCourse was initially announced by the Commissioner on 7 April 1992 in Sydney and is now run in conjunction with TAFE institutions in each state. The course has a practical orientation and provides an overview of the taxes involved in running a business, including capital gains tax, prescribed payments, PAYE and sales tax. It has a strong emphasis on the record keeping requirements for small business.

**Survey Question:**

1(a) *Can you name any agencies or organisations that provide training in taxation matters for small business operators?*

**Figure 1: Training Institutions**



A high proportion of respondents (67.5%) were unable to name an institution that provided training courses on taxation. The most frequently recalled institution was the Small Business Development Corporation (SBDC) (9.6%) followed by TAFE (8.6%) and the ATO (6%).

Sole traders seem to be more aware (44.4%) of organisations which provide training courses compared to businesses structured as trusts (34.5%), partnerships (27.3%) or companies (24.2).

The highest awareness among industry sectors was community services (44%), construction (37%) and recreation and personal services (35%). Although turnover, profit trend and the number of employees did not show any distinguishing trend, it would seem that older, established businesses were *less* likely to know of agencies offering training to small businesses than more recently established businesses as follows (see Table :8)



Table 8: Knowledge of Training Agencies by Age of Business

age of business in years	< 1	2 - 3	4 - 5	6-10	> 10
unable to name any agencies %	62.2	54.8	73.2	73.1	72.8

Respondents describing themselves as family businesses were less able to name any relevant training agencies (70.3%) as compared to non family businesses (63.5%). Respondents who had a tertiary qualified person attending to their tax affairs were better able to name training agencies. This is possibly because non-family structures are more likely to have a tertiary qualified person on staff.

**Survey Question:**

*1(b) Has anyone at [the business] attended any courses relating to obligations under Income Tax Legislation?*

*1(c) Which position do they hold?*

An alarming majority of the small businesses surveyed have not actually sent anyone from the business on taxation related courses (86%). Again, more non family businesses attended courses (18.3%) as compared to family businesses (11.8%) and those with tertiary qualifications (20%) sent more than those without (1%). Where businesses had sent employees on such courses, the representative would usually be described as manager (38%), bookkeeper/financial controller (26%) or owner of the business (24%).

**Survey Question:**

*1(d) Where was the course held?*

A total of 42 respondents indicated that they had sent an employee from the business on a taxation education programme, the most frequently nominated venue being TAFE (14%) and the SBDC (12%)

**Survey Question:**

*1(e) When was the course held?*

Attendance at educational courses appears to be mildly fluctuating over the past five years, bearing in mind that with a small sample of 42 businesses, care must be exercised in interpreting the results (see Table 9):

Table 9: Attendance at Courses

When was the course held	%
Before 1990	25%
During 1991	19%
During 1992	13%
During 1993	19%
During 1994	25%

**Survey Question:**

2(a) Does [the business] intend to have someone attend such a course?

2(b) Why do you say that?

Only 8% of small business organisations who have not sent employees on taxation training courses expressed an intention to do so in the future. Businesses with higher turnover seem more likely to want to send someone in the future to such a course and those with increasing profit trends also seem more likely as follows (see Tables 10 & 11):

**Table 10: Intention to attend by turnover**

Turnover \$000	<50	50 - 100	101- 200	201- 500	500- 1,000	1,000- 2,000	>2,000
% intending to have someone attend	7.3%	3.3%	3.1%	17.15%	10%	14.3%	27.3%

**Table 11: Intention to attend by profit trend**

Profit trend	increasing significantly	increasing slightly	stable	decreasing slightly	decreasing significantly
% intending to have someone attend	11.1%	9.8%	7.6%	7.9%	0%

Similarly, those businesses with more employees are more likely to intend to send someone on a course. This is to be expected as the level of obligation increases with increases in turnover and the number of employees. It is possible that the increasing interest in sending someone on a course corresponding to an increase in profitability reflects a concern with ensuring that the minimum amount of tax is paid.

The main reason given for not utilising training courses was

- that they had “an accountant who handled that” (49%) or
- that they could see “no need” (29.3%).

10.6% of respondents felt that the business was “too small” presumably to justify the expense and 4.9% said they were inhibited by a lack of time. One respondent commented that he/she had “done it for twenty years” and felt that they had the knowledge needed. The respondent went on to say that he uses Tax Pack. Given the admitted errors in the 1995 Tax Pack, it must be questioned whether the respondent’s faith in the ATO publication is justified!

**5.2. INFORMATION ABOUT TAXATION OBLIGATIONS**

The ATO is aware that different small business segments have different information needs and therefore different preferences as to the manner of delivering that information. In an address to the Taxation Institute of Australia, an ATO officer noted

that the ATO is moving towards developing a 'first stop shop' for small business tax needs, reviewing small business tax needs generally and implementing a taxation ruling/taxation determinations program targeting small businesses.

**Survey Question:**

3(a) *How do you currently obtain information about your taxation obligations?*

Most small businesses (60.3%) obtain information about their taxation obligations from an accountant / tax agent. The next most common source of information is printed materials by the ATO (37.7%). An analysis by the type of business structure indicates that businesses operated through more complex structures, that is, companies and trusts rely on printed ATO material (34%) less than sole traders (36.1%) and partnerships (38.6%).

Businesses involved in construction (60%), and community services (52.9%) appear to be more inclined to use printed materials issued by the ATO than other sectors. Analysis by level of gross sales/receipts indicates little difference between those business with gross receipts of less than \$200,000, 66% of whom obtain information from accountants/tax agents and 36% of whom obtain information from printed ATO material, and those with gross receipts in excess of \$200,000 (65% and 35% respectively).

**Survey Question:**

3(b) *What do you believe is the best way of providing information about taxation obligations to small businesses?*

42% of businesses nominated printed materials issued by the ATO as being the best method of obtaining information about their income tax obligations. The next preferred method was through an accountant/tax agent (29.6%). Only 4% would best obtain information by ringing the ATO, which perhaps speaks volumes for the ATO enquiry service.

By type of structure, more complex structures seem to have a preference for obtaining information from accountants/tax agents than from the ATO, as compared to more simple structures being sole traders and partnerships, as follows (see Table 12):

**Table 12: Obtaining tax information by structure**

Structure	Sole Trader	Partnership	Company or Trust
Best though ATO Printed materials	44.4%	40.9%	31%
Best from accountant/tax agent	27.8%	27.3%	35%

This is perhaps because the more complex structures have more contact with accountants and tax agents during the year.

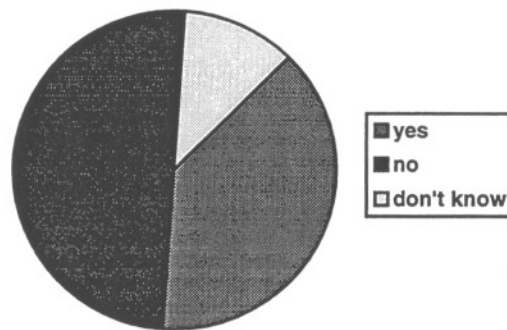
In terms of gross receipts/sales of the business, 40% of those with gross receipts of \$200,000 or less indicated a preference for ATO print materials and 28% of such

businesses indicated a preference for accountant/tax agent as a source of information. Of those businesses with gross sales/receipts in excess of \$200,000, 44% preferred ATP publications and 31% accountant/tax agent.

**Survey Question:**

4. Do you believe that small businesses are well informed about obligations under income tax legislation?

**Figure 2: Are Small Businesses Well Informed?**



Most small businesses (50%) are of the view that they are not well informed about their taxation obligations. 20.8% of those who believe they are not well informed stated that the information they do receive is unclear or too complex and 12% stated that they cannot keep abreast of changes. 29.5% said that not enough information comes through from the ATO and 10.9% said "you have to ask/find out for yourself".

Sole traders (54.2%) and partnerships (50%) considered that they were not as well informed than were business operated under more complex structures (46%). The implication here is that the more sophisticated structures have qualified advisers. 66.7% of businesses involved in the manufacturing sector indicated that small businesses are not well informed, more than any other sector.

55% of businesses with a gross turnover in excess of \$200,000 considered that small businesses are not well informed about their tax obligations, as did 53% of business with a turnover of \$200,000 or less. Only 33% of businesses with a gross turnover in excess of \$200,000 considered that small businesses are well informed about their tax obligations as compared to 40% of those with a turnover of \$200,000 or less.

One respondent, a registered tax agent, commented that small businesses are "completely ignorant" of tax matters. Another respondent, in indicating that there is not enough information, commented that it is "something people don't talk much about, which is unfortunate."

### 5.3. KEEPING TAX RECORDS

The self assessment system has placed considerable burdens on taxpayers to maintain records necessary to ascertain accurately their income and expenditure for tax

purposes. Section 262A of the *Income Tax Assessment Act* was amended to add record keeping requirements for persons carrying on a business akin to those applicable to the substantiation provisions for employees in terms of rigour.

**Survey Question:**

5(a) *Considering that tax records are not only tax returns, but also receipts, invoices and books of account used to prepare the return, who is responsible for preparing the records of the business?*

Almost half of the businesses surveyed (47.4%) indicated that the owner of the business was the person responsible for preparing tax records. A higher proportion of businesses structures as “partnerships” or “sole traders” (55.6% and 59.1% respectively) have their tax records prepared by the owner of the business as compared to 36% for companies.

The respondents with a larger turnover in terms of gross sales were less likely to have the owner responsible for the preparation of the records of the business, indeed only 18.75% of businesses with gross sales in excess of \$1million did so as compared to 52.63% of those with a turnover less than \$1million.

Similarly, and as would be expected, the larger the firm in terms of the number of employees, the more likely it is that an employee rather than the owner would be responsible for preparing the records of the business.

In terms of whether or not the business is a family business, the results for this question were as follows:

Table 13: Owner Record Keepers

Family Business?	Yes	No
Owner	55.9%	32.7%
employee	12.8%	26.9%
Tax Agent	27.7%	35.6%

**Survey Question:**

5(b) *Who actually keeps the tax records for the business?*

As with the previous question, most businesses (62.9%) specified the “owner of the business” as being the keeper of taxation records. Similarly, the higher the level of gross sales, the more likely the business was not to use the owner of the business as the keeper of records. Indeed 67.7% of respondents with gross sales less than \$1million used the owner of the business as compared with 31.25% of those with gross sales in excess of \$1million.

**Survey Question:**

6(a) *Have you ever seen the ATO publication “A Guide to Keeping Your Business Records”?*

6(b) *Who showed it to you/gave it to you?*

Interestingly only 17.9% of the small businesses surveyed were aware of the ATO publication "A Guide to Keeping Your Business Records". Given that the ATO prides itself on the production of this guide, it is surprising it does not have wider community distribution.

Of the small number that were aware of the publication, 55.6% learned of it through the ATO itself, and 20.4% from their accountant.

#### 5.4. TAX OFFICE AUDITS

The Taxpayer Audit Group of the ATO is structured on market segmentation lines and conducts research aimed at identifying high risk areas for targeting. The audit programs are as follows:

- Complex Audit - largest and more complex corporations, industries and issues;
- Business Audit - taxpayers whose incomes comes mainly from business (other than complex);
- Primary Audit - individuals who are employees, prescribed payments system (PPS) payees, pensioners or investors.;
- Source deduction Audit - individuals and businesses involved in PAYE or PPS; and
- Special Audit - those persons engaged in criminal pursuits.

The following table is based on information contained in the Commissioner's Annual Reports for the relevant years and reflects Business Audits conducted over the last five years.

Table 14: ATO Business Audits

	No of entities audited	number revealing omissions	total adjustments \$millions
<b>Companies</b>			
1989/90	1164	742	101.8
1990/91	1772	1102	170.9
1991/92	2047	1197	199
1992/93	2316	1218	194
1993/94	2211	1066	142
<b>Trusts</b>			
1989/90	623	398	34.2
1990/91	931	561	48.1
1991/92	857	480	44
1992/93	938	458	39
1993/94	780	389	34
<b>Partnerships</b>			
1989/90	1269	794	27.7
1990/91	1454	943	36.2
1991/92	1122	670	35



1992/93	1273	615	26
1993/94	1359	644	38
<b>Individuals</b>			
1989/90	3310	2619	101.8
1990/91	3894	2858	104.9
1991/92	4719	3167	127
1992/93	4579	3135	117
1993/94	4729	3177	101
<b>Total</b>			
1989/90	6366	4553	265.5
1990/91	8051	5464	360.1
1991/92	8745	5514	405
1992/93	9106	5426	376
1993/94	9079	5276	315

**Survey Question:**

7(a) *Has [the business] been audited by the Australian Taxation Office in the last 5 years, other than record keeping audits?*

The majority of small businesses surveyed (82.1%) indicated that they had not been audited. Of the 38 respondents who indicated they had been audited, 78.9% stated that no penalties or fines were imposed. A comparatively higher proportion of companies have been audited (17.2%) as compared to partnerships (12.5%), trusts (10.3%) non-profit organisations (8.3%) and sole traders (8.3%).

This compares with the ATO data (from table 14) which shows that for 1994 24% of business audits were of companies, 9% were of trusts, 15% of partnerships and 52% of individuals.

Given that the number of respondents involved (38) dictates that caution be exercised in interpreting the results, it would nevertheless seem that businesses with a higher turnover, increasing profit trend and more employees are more likely to be audited, as demonstrated by the following tables (see Tables 15, 16 & 17 respectively):

**Table 15: Percentage audited by turnover**

Turnover \$000	<50	50 - 100	101- 200	201- 500	500- 1,000	1,000- 2,000	>2,000
% which have been audited	10.4	6.1	11.4	10.3	8.6	26.7	29.4

**Table 16: Percentage Audited by Profit Trend**

Profit trend	increasing significantly	increasing slightly	stable	decreasing slightly	decreasing significantly
% which have been audited	16.7	11.4	11.1	9.5	10

Table 17: Percentage Audited by Number of Employees

Number of employees	<2	2-4	5-10	11-20	>20
% which have been audited	9.8	8	11.2	26.9	29.2

**Survey Question:**

7(b) *Were any penalties or fines imposed?*

Of the 38 businesses which had been audited, only 15.8% advised that penalties or fines were imposed.

**5.5. PENALTIES**

The changes to the income tax penalty regime which took place in 1992 have introduced a new concept into the application of penalties being that of “reasonable care”. It is a common law concept which requires a taxpayer to exercise the same level of care that a reasonable ordinary person would be likely to exercise in the circumstances of the taxpayer. Thus it looks to the attributes of the taxpayer concerned in determining the level and appropriateness of penalties imposed.

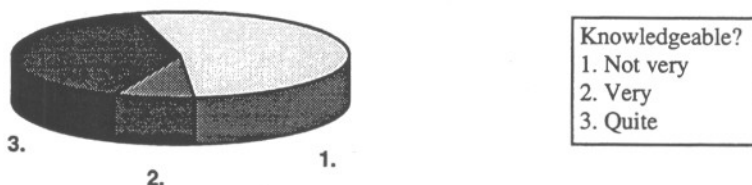
The Explanatory Memorandum issued by the government when the new legislation was introduced stated that, for the business taxpayer, the concept of reasonable care means putting in place appropriate record keeping systems and procedures to ensure that income and expenses are properly recorded and classified. Consideration is given to the size of the business and the level of training of accounting staff in determining what is “reasonable”. The taxpayer’s knowledge, education, experience and skill will also be relevant.

**Survey Question:**

8(a) *Thinking now about the level and kinds of penalties that can be imposed under Income tax legislation for not keeping correct records, how knowledgeable are you regarding the penalties that can be incurred?*

*Very knowledgeable, Quite knowledgeable or not very knowledgeable.*

Figure 3: Knowledge of Penalties





The majority of small businesses surveyed considered that they were not very knowledgeable regarding penalties (52.6%). only 7.9% of businesses said they were very knowledgeable. Of the 72 sole traders surveyed, 11.1% said they were very knowledgeable. It was beyond the parameters of the survey to attempt to establish whether or not these respondents actually were very knowledgeable or just thought they were.

It would seem that those businesses with lower turnover (other than those over \$2m) and those with fewer employees are less likely to be knowledgeable about the penalty regime, as demonstrated in the following tables (see Tables 18 & 19 respectively):

Table 18: Knowledge of Penalties by Turnover

Turnover \$000	<50	50 - 100	101- 200	201- 500	500- 1,000	1,000- 2,000	>2,000
% not very knowledgeable	64.6	60.6	45.7	48.7	42.9	46.7	64.7

Table 19: Knowledge of Penalties by Number of Employees

Number of employees	<2	2-4	5-10	11- 20	>20
% not very knowledgeable	54.1	57.3	50	46.2	41.7

Given the potential for the prospect of penalties to serve as a deterrent for errant behaviour in tax compliance terms, the fact that over half the businesses involved in the survey felt that they were not knowledgeable regarding penalties is of some concern and suggests that the ATO does not inform small business operators of prospective penalties, or that if they do, it is lost in amongst other information provided.

**Survey Question:**

8(b) *In considering whether to impose penalties for incorrect income tax returns the Commissioner of Taxation considers whether a taxpayer has used “reasonable care” in preparing tax returns. What does the term “reasonable care” mean to you?*

The majority of small businesses (61.6%) associate the term “reasonable care” with keeping good/accurate records, while a quarter (25.2%) stated it meant “working to the best of your ability/knowledge/all due care taken.” 11.9% said “be honest” and 2.3% didn’t know.

One respondent stated that it means “read literature about tax and take precautions to prepare everything accurately” another stated that reasonable care means “anything the Commissioner of Taxation designates”!

In a recent study of small business in New South Wales<sup>9</sup> in relation to penalties, some participants were of the view that the ATO had little empathy with the plight of small business in the imposition of penalties and that consideration should be given to a two year moratorium on penalties for non-deliberate errors. Perhaps the market segmentation of the ATO into business lines will allow this situation to improve as guidelines and precedents relating to the concept of “reasonable care” are more fully developed internally.

## 5.6. TAX AGENT NEGLIGENCE

The National Review of Standards for the Tax Profession has explored the possibility of a separate regime for penalties for negligent tax agents. It has been argued that such a regime is not necessary, that the common law remedies coupled with the statutory sanctions provided by the *Tax Administration Act* and section 251M of the *Income Tax Assessment Act* adequately deal with delinquent agents.<sup>10</sup>

### *Survey Question:*

9. *What should happen if a registered tax agent makes a mistake in preparing the tax return of the business which results in the business incurring penalty tax?*

In relation to errors occurring through tax agent negligence, 45% of businesses indicated that the agent should be penalised and not the business. 19% stated that the business should recoup the penalty from the agent. Responses were as follows:

Table 20: Tax agent negligence

What should happen	Total %
Agent separately penalised	45.4
Business recoups penalty from agent	19.2
Nothing	9.6
Other	9.3
Owner responsible/owner should check	4.6
Agent should be given a chance to explain	3.6
Agent struck off	3.3
Agent responsible	3.3
Don't know/no comment	1.6

Responses to this question were similar across business structure types.

<sup>9</sup> Conducted by Ian Wallchutzky and Brian Gibson, “How can revenue authorities help small business” APTRIC Bulletin Nov/Dec 1993

<sup>10</sup> see for example Oats, L, Pinto, D; and Sadler, P “Penalties for Preparers : Part 1 Duty of Care”, *Taxation in Australia Red Edition* Vol 3 No2 pp 82 - 88.

## 5. 7. SEEKING TAX ADVICE

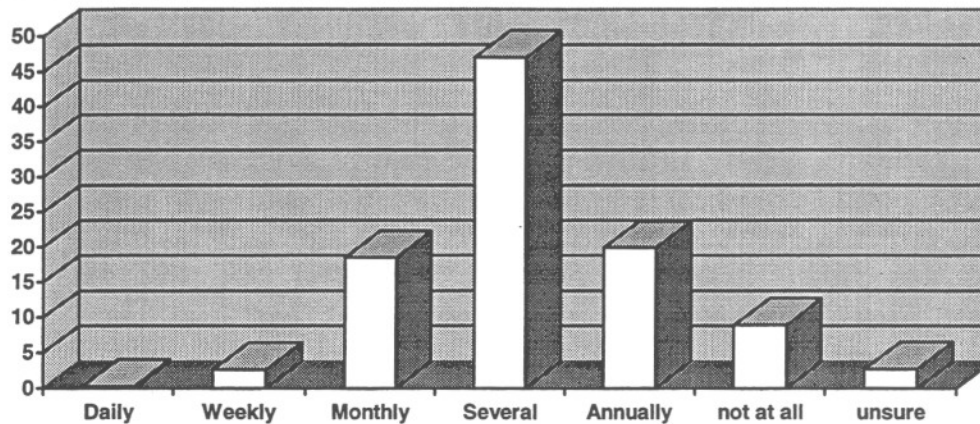
In the Small Business Survey conducted for the Bureau of Industry Economics in 1985<sup>11</sup>, the owners/managers were asked to indicate the reasons for engaging the services of a practising accountant and the majority (87%) indicated they did so to assist in the preparation of taxation returns, contact taking place on a quarterly or half yearly basis.

Johns et al<sup>12</sup> note that while the evidence is that small firms generally seek advice from external consultants in taxation matters, most is in relation to tax return preparation. The high cost of consultancy may be prohibitive for small business operators and there is a danger that transactions are not structured in the most tax effective way as a result.

### *Survey Question:*

10 How often does [the business] seek advice from external tax advisers?

**Figure 4 : Frequency of contact with external advisers.**



Most of the businesses surveyed (47%) seek advice from external tax advisers several times a year. As would be expected, businesses structured as companies, partnerships and trusts are more likely to seek advice several times a year than are those operated as sole traders (33%), although in light of the small sample size, analysis by structure must be treated with caution.

An alarming 19.9% of businesses said they would seek advice only once a year, and 8.9% said they would not seek advice at all.

Not unexpectedly, businesses with higher levels of sales appear to be more likely to go monthly or more often, as are those with more employees and a positive profit trend.

<sup>11</sup> supra note 2

<sup>12</sup> Small Business in Australia

**Survey Questions:**

- 11(a) *Would you seek advice from external advisers before making a capital investment such as buying new plant or equipment or expanding the business?*
- 11(b) *Who do you generally seek advice from?*

The majority of small businesses (67%) confirmed that they would seek advice from external tax advisers prior to making a capital investment such as buying new plant or expanding the business and 81.5% said (reassuringly) that they would seek advice from their accountant.

This corresponds with findings in the 1985 Small Business Survey<sup>13</sup> in which 55% of small business owner/managers stated they would “always” or “usually” consult an accountant when analysing the feasibility of a large financial outlay or commitment. The remaining respondents apparently made contact “half the time”, “occasionally” or “not at all”.

## 5.8. ADVICE FROM THE ATO

The Small Business Council<sup>14</sup> noted small business operators are often obliged to pay substantial amounts to obtain advice regarding their taxation obligations and that considerable advantages attach to enterprise size in relation to access to such information. It recommended *inter alia* an ATO “One Stop Shop” for the provisions of taxation advice with perhaps a hot-line for small businesses, respecting, of course, the small business operator’s concern for the preservation of anonymity.

The ATO has a Taxpayer Assistance Group whose primary role is to assist taxpayers in understanding their rights and obligations under the taxation law with a view to increasing voluntary compliance. The group is responsible for *inter alia*, the public enquiry service, preparing publications for taxpayers and reviewing and monitoring the quality of advice provided to taxpayers.

**Survey Question:**

- 12(a) *Has the business ever approached the ATO for tax advice?*

Almost half of the businesses surveyed (48.7%), however, stated that they had not directly approached the ATO for tax advice. There is possibly an element of fear attached to approaching the ATO, assurances of impartiality by the ATO will always fail in some sectors of the community, and to this extent the Small Business Council’s suggestion may not succeed. There is also the possibility that the service provided by the ATO is inadequate as the response to the next question indicates. The provision of advice to small business may well be better left with such organisations as the Small Business Development Corporations.

**Survey Questions:**

- 12(c) *How satisfied were you with the service provided?*

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<sup>13</sup>supra note 2

<sup>14</sup>“Taxation and Small Business in Australia” Discussion Paper, AGPS Canberra, 1989

*12(d) Why?*

Of the 147 respondents who had approached the ATO for advice, 22% stated that they were “very satisfied” and 49% moderately satisfied with the level of service they received. 12.2 % of respondents were dissatisfied with the service provided.

When asked why they rated their satisfaction with the ATO in the way they did, the responses were:

- |  |     |
|--|-----|
| • helpful/polite/prompt/good service                       | 49% |
| • Information given was poor/inadequate/insufficient/wrong | 18% |
| • Long wait to get through/on hold                         | 18% |
| • Poor service/ Slow/ Rude/ Not helpful                    | 13% |
| • Other  | 16% |
| • Don't know   | 4%  |

The Commissioner has noted that research on large, medium and small businesses to gauge their level of satisfaction with services provided shows that generally businesses “believe that the information they obtain from the Tax office is accurate but that the accessibility and timelines needs improvement.”<sup>15</sup> The research has apparently also shown that small business operators rarely contacted the ATO.

The Beddall Enquiry recommended that the ATO should improve its advisory services to small business by establishing a single contact point with a toll free hotline and also suggested outposting ATO advisers in small business advisory organisations to train staff.

In Western Australia the restructure of the ATO into big business, small business and individual segments is expected to be complete by December 1995. The needs of each of these sectors of the taxpaying population differ according to Mr John Nicholls<sup>16</sup>, big business non-compliance stems largely from differences in legal interpretation, for individuals non-compliance relates mainly to work related expenses, but for small business it is associated mainly with record keeping and the failure to lodge returns. The new structure of the ATO will apparently allow taxpayers to obtain a more efficient service from the ATO “People will have all their queries answered in one place rather than going from place to place.” It must be remembered, however, that this new system will be equally frustrating for those with both say business and individual enquiries.

***Survey Question:***

- 13 *Are you aware that the ATO will issue rulings on request in respect of contentious taxation matters.*

The new system of public and private rulings is not without its problems, about which much has been written. It is interesting to obtain a measure of community awareness of the system and for this reason small business operators were asked if they were aware that rulings are available on request.

<sup>15</sup> Commissioner of Taxation Annual Report to Parliament 1993 p.20

<sup>16</sup>Deputy Commissioner Cannington Office of the ATO quoted in an article in the Western Australian Tuesday December 27 1994 p 59

The majority of small businesses (61.6%) were aware that the ATO will issue rulings on request if a contentious issue arises in relation to a taxation matter. This response was fairly consistent across structure type.

## 5.9. GENERAL COMMENTS

### *Survey Question:*

14 *Do you have any general comments about income tax for small business?*

All of the respondents to the survey were provided with the opportunity to comment generally about income tax for small business, and many indicated they had no comment (36.8%). The most common response, given by nearly one quarter of respondents, was that income tax for small business was “too much/too high/too expensive”.

Other responses of interest include:

3% of respondents made specific mention of their objection to provisional tax. In relation to provisional tax, the Beddall Enquiry<sup>17</sup> noted that the “double slug” of provisional tax necessary in the first year of operation of a small business conducted by an individual alone or in partnership “may have severe consequences for the viability of an incipient small business because of its effect on the business’s cash flow.” It accordingly recommended a deferral or concession on payment of provisional tax for small businesses paying provisional tax for the first time, although it must be remembered that generally provisional tax is not payable until nine months into the year to which it relates.

8.3% stated that there was too much paperwork and it was too time consuming.

5.3% of respondents stated that there was no incentive for small businesses to expand.

## 6. CONCLUSION

The ATO has recognised the special needs of small businesses in terms of compliance with taxation laws and appears to be working with both the community and the profession in addressing the issues peculiar to that segment of the taxpaying population. According to the Taxation Institute<sup>18</sup> the ATO’s Small Business Consultative Committee is currently studying the compliance costs of small business with particular concern for easier record keeping requirements, fewer tax forms by eliminating duplications across revenue lines and addressing the information needs of small business.

This spirit of co-operation with the community and the profession in tackling the taxation compliance issues facing small business is to be applauded, but one is forced

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<sup>17</sup> supra note 2

<sup>18</sup> in Tax Bulletin the WA Branch Newsletter February 1995



to ask whether the ATO is going far enough or merely paying lip service to assisting small business in meeting tax obligations. There is merit in the suggestion that the ATO's role is becoming blurred and that attempts to become the benign educator extending a friendly helping hand to taxpayers in need are misplaced. Perhaps the ATO should concentrate on enforcement and leave taxpayer education to those best placed to provide it.

It is hoped that the future will see a higher level of awareness of compliance obligations, although as mentioned at the start of the paper, there will always be a core of small business taxpayers who have no desire to improve their compliance levels and will continue to play the audit lottery come what may.

**APPENDIX A**  
The Survey Instrument

Good (...), my name is (...) from Reark Research, and we are currently undertaking a survey of small business on behalf of Curtin Business School regarding taxation. This survey is in no way connected with the ATO (Australian Taxation Office). May I please speak to the owner of the business?

**(Please reassure respondents this survey is confidential and is in no way connected with the ATO>**

**(Re-introduce if necessary) If unavailable, make an appointment to re-contact.)**

S1. Are you primarily responsible for accounting/tax matters as well as being the proprietor of the business?

Yes (Go to Q. 1a)..... 1  
No (Continue)..... 2

S2. Could you please tell me who within the business would be the most appropriate person to contact?

\_\_\_\_\_

Q. 1a) Can you name any agencies or organisations that provide training in taxation matters for small business operators?

Australian Taxation Office ..... 1  
Chamber of Commerce and Industry ..... 2  
TAFE..... 3  
Australian Society of Certified Practising Accountants..... 4  
Curtin Business School ..... 5  
Small Business Development Corporation ..... 6  
other (Please specify below)..... 7

\_\_\_\_\_

Q. 1b) Has anyone at (State the name of company/business) attended any courses relating to obligations under Income Tax Legislation?

Yes (Continue) ..... 1  
No (Go to Q. 2a)..... 2

Q. 1c) Which position do they hold?

Manager..... 1  
Bookkeeper/Financial Controller..... 2  
other (Please specify below)..... 3

\_\_\_\_\_

Q. 1d) Where was the course held?

Australian Taxation Office ..... 1  
Chamber of Commerce and Industry ..... 2  
TAFE..... 3  
Australian Society of Certified Practising Accountants..... 4  
Curtin Business School ..... 5  
Small Business Development Corporation ..... 6  
other (Please specify below)..... 7

\_\_\_\_\_

Q. 1e) When was the course held? (Date of Taxation Course?)

Date: \_\_\_\_\_

**GO TO Q. 3A)**

Q. 2a) Does (State the name of company/business) intend to have someone attend such a course?

Yes .....1  
No.....2

Q. 2b) Why do you say that?

\_\_\_\_\_  
\_\_\_\_\_

Q. 3a) How do you currently obtain information about your taxation obligations? (Circle response in column Q. 3a)

Q. 3b) What do you believe is the best way of providing information about taxation obligations to small business? (Circle response in column Q. 3a)

	Q3a	Q3b
Printed material issued by the Australian Taxation Office	1	1
Printed material issued by another organisation (Record below the organisation mentioned)	2	2
Seminars/courses run by the Australian Taxation Office	3	3
Seminars/courses run by another organisation (Record below the organisation mentioned)	4	4
Don't know/Unsure	5	5
Other (Please specify below)	6	6

\_\_\_\_\_

Q. 4a) Do you believe that small businesses are well informed about obligations under income tax legislation?

Yes (Go to Q. 5a) .....1  
No (Continue).....2  
Don't know (Continue) .....3

\_\_\_\_\_

Q. 4b) Why do you say that?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_



Q. 5a) Considering that tax records are not only tax returns, but also receipts, invoices and books of account used to prepare the return. Who is responsible for preparing the tax records for the business?

- Owner of the business 1
- Employee 2
- Tax Agent 3
- other (Please specify below) ..... 4

Q. 5b) Who actually keeps the tax records of the business?

- Owner of the business 1
- Employee 2
- Tax Agent 3
- other (Please specify below) ..... 4

Q.6a) Have you ever seen the ATO publication 'A Guide To Keeping Your Business Records'?

- Yes (Continue) ..... 1
- No (Go to Q.72a) ..... 2

Q. 6b) Who showed it to you/gave it to you?

- Accountant 1
- Friend 2
- ATO (Australian Taxation Office) 3
- other (Please specify below) ..... 4

Q7.a) Has (State name of business/company) been audited by the Australian Taxation Office in the last 5 years, other than record keeping audits?

- Yes (Continue) ..... 1
- No (Go to Q. 8a) ..... 2
- Don't know (Go to Q. 8a) ..... 3

Q.7b) Were any penalties or fines imposed?

- Yes ..... 1
- No ..... 2
- Don't know ..... 3

Q.8a) Thinking now about the level and kinds of penalties that can be imposed under Income Tax Legislation for not keeping correct records, how knowledgeable are you regarding the penalties that can be incurred? (Read out)

- Very knowledgeable ..... 1
- Quite knowledgeable ..... 2
- Not very knowledgeable ..... 3

Q. 8b) In considering whether to impose penalties for incorrect income tax returns the Commissioner of Taxation considers whether a taxpayer has used 'reasonable care' in preparing tax returns.

What does the term 'reasonable care' mean to you?

\_\_\_\_\_

\_\_\_\_\_

Q9. What should happen if a registered tax agent makes a mistake in preparing the tax return of the business which results in the business incurring penalty tax?

- Nothing 1
- Business should recoup penalty from agent 2
- Agent should be penalised separately 3
- Agent should be struck off 3
- other (Please specify below) ..... 4

Q.10. How often does (State name of business/company) seek advice from external tax advisers?

- Daily 1
- Weekly 2
- Monthly 3
- Several times a year 4
- Once a year 5
- Not at all 6
- other (Please specify below) ..... 7

Q.11a) Would you seek advice from external advisers before making a capital investment such as buying new plant and equipment or expanding the business?

- Yes ..... 1
- No ..... 2
- Don't know ..... 3

Q.11b) Who do you generally seek advice from?

- ATO (Australian Taxation Office) ..... 1
- Accountant ..... 2
- Small Business Development Corporation ..... 3
- Family/ friends ..... 3
- other (Please specify below) ..... 4

Q.12a) Has the business ever approached the Australian Taxation Office for tax advice?

- Yes (**Continue**) ..... 1  
 No (**Go to Q. 13**) ..... 2

Q.12b) Which office?

- Cannington ..... 1  
 Northbridge ..... 2  
 Other (**Please specify below**) ..... 3

Q12c) How satisfied were you with the service received? (**Read out and circle appropriate response**)

- Very satisfied ..... 1  
 Moderately satisfied ..... 2  
 Indifferent ..... 3  
 Moderately dissatisfied ..... 4  
 Very dissatisfied ..... 5

Q12d) Why do you say that?

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Q13) Are you aware that the ATO (Australian Taxation Office) will issue rulings on request in respect of contentious taxation matters?

- Yes ..... 1  
 No ..... 2

Q14) Do you have any general comments about income tax for small business?

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Finally, I would now like to ask you a few questions about the structure of your business as well as general demographic questions.

Q15. What is the main structure of your business?

- Sole Trader ..... 1  
 Partnership ..... 2  
 Trust ..... 3  
 Company ..... 4  
 Non-profit organisation ..... 5  
 other (**Please specify below**) ..... 6

Q16. What is the main business activity? (**Record one only**)

- Primary Production ..... 1  
 Mining ..... 2  
 Manufacturing ..... 3  
 Wholesale trade ..... 4  
 Retail Trade ..... 5  
 Construction ..... 6  
 Transport, storage and communication ..... 7  
 Finance, insurance and banking ..... 8  
 Health & Community Services ..... 9  
 Entertainment, hotels etc. .... 10  
 Property development and ownership ..... 11  
 Other (**Please specify below**) ..... 12

Q.17 What were the gross sales/receipts of the business last accounting year? (**Approximate if not sure**)

- Less than \$50,000 ..... 5  
 \$50,001 to \$100,000 ..... 1  
 \$100,001 to \$200,000 ..... 2  
 \$200,001 to \$500,000 ..... 3  
 \$500,001 to \$1,000,000 ..... 4  
 Between \$1m and \$2m ..... 5  
 Over \$2m ..... 6

Q18. What has been the trend of gross income of the business over the period of ownership?

(**Read out**)

- Less than 2 employees ..... 1  
 2 to 4 employees ..... 2  
 5 to 10 employees ..... 3  
 11 to 20 employees ..... 4  
 More than 20 employees ..... 5

Q20 How long has the business been under the current ownership?

- Less than 1 year ..... 1  
 2 to 3 years ..... 2  
 4 to 5 years ..... 3  
 6 to 10 years ..... 4  
 More than 10 years ..... 5

Q21 Is this a family business?

- Yes..... 1
- No..... 2

---

Q.22 What is the highest educational qualification of the person responsible for the day to day accounting/tax matters of the business (Circle one only)

- Primary School..... 1
- 1 to 3 years of secondary school..... 2
- 4 to 5 years of secondary school..... 3
- Qualified tradesperson ..... 4
- Tertiary: Bachelors degree/diploma ..... 5
- Tertiary: Postgraduate ..... 6
- Don't know ..... 7

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**THANK THE RESPONDENT AND CLOSE  
INTERVIEW**

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Company Name: \_\_\_\_\_

Telephone number: \_\_\_\_\_

Respondent Name: \_\_\_\_\_

Respondent Title: \_\_\_\_\_

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Interviewer Name: \_\_\_\_\_

Interview number: \_\_\_\_\_

Date of Interview: \_\_\_\_\_

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**Interviewer Declaration**

'I certify this is a correct record of the interview which has been completed in accordance with my interviewing guidelines and conducted according to the ICC/ESOMAR International Code of Marketing and Social Research Practice.

Signed: \_\_\_\_\_