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#### **Tax Issues Entry System – Issue for Submission**

- 1. Please provide your contact details (full name, postal address, contact details during business hours, email address).***

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- 2. Do you represent a professional body, company or firm? If so please provide details (optional).***

Taxation Institute of Australia  
Level 2, 95 Pitt Street  
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Tel: +61 2 8223 0000  
Contact: Deepti Paton (Tax Counsel)

- 3. What is your role in that professional body, company or firm (optional)?***

Chair of the Taxation Institute of Australia CGT & Losses sub-committee.

**4. What area of the law are you concerned about (i.e. GST, superannuation, capital gains tax)?**

Capital gains tax – small business CGT concessions.

**5. What Act (including the year of enactment) and section does this issue relate to?**

Income Tax Assessment Act 1997, Division 152, Section 152-70.

**6. Please describe your issue in general terms as clearly as possible.**

All legislative references are to the *Income Tax Assessment Act 1997*.

In order to obtain the benefit of the small business CGT concessions, if the relevant CGT asset is either a share in a company or an interest in a trust, the taxpayer must either be (subsection 152-10(2)):

- a. a CGT concession stakeholder in the object company or trust; or
- b. CGT concession stakeholders in the object company or trust together have a small business participation percentage in you of at least 90%.

Further, the Small Business 15 Year Exemption in Subdivision 152-B and the Small Business Retirement Exemption in Subdivision 152-D require as a special condition that the individual taxpayer concerned is a CGT concession stakeholder of a company or trust, or that a taxpayer that is a company or trust has a significant individual. In this respect, see sections 152-105(c), 152-110(1)(c), 152-305(2)(b), 152-315(5) and 152-325(1).

Under section 152-60, an individual is a CGT concession stakeholder of a company or trust if the individual is:

- a. a significant individual in the company or trust; or
- b. a spouse of a significant individual in the company or trust, if the spouse has a small business participation percentage in the company or trust at that time that is greater than zero.

Under section 152-55, an individual is a significant individual in a company or a trust at a time if, at that time, the individual has a small business participation percentage in the company or trust of at least 20%.

Section 152-65 sets out that an entity's small business participation percentage is equal to the sum of:

- The entity's direct small business participation percentage; and
- The entity's indirect small business participation percentage.

For these purposes, "direct small business participation percentage" is relevantly defined in section 152-70 (in relation to an entity's direct small business participation percentage in a company) as:

"This percentage that the entity has because of holding the legal and equitable interests in shares in the company:

the percentage of the voting power in the company; or

- a. the percentage of any dividend that the company may pay; or
- b. the percentage of any distribution of capital that the company may make;

or, if they are different, the smaller or smallest.”

In relation to (a) above, where shares are held jointly by several persons, each such joint holder may under this section (as currently drafted) be taken to hold a percentage of voting power of nil, as none of the joint holders individually control the voting power bestowed on the jointly held shares.

Further, as this will be the smallest percentage when applying (a), (b) or (c) in the test above, the joint holders will each be taken to have a direct small business participation of nil.

As a result, the operation of this section in the context of joint shareholdings may result in taxpayers who otherwise hold an economic interest in a company of more than 20% not being able to satisfy the significant individual test. This outcome will result in affected taxpayers being denied the benefit of the small business CGT concessions where there is no economic rationale for that denial.

This outcome is clearly contrary to the legislative intention of these provisions.

An example is as follows:

- 33.33% of the shares in a company are held jointly by 3 individuals.
- In this situation, each individual's direct small business participation percentage in the company will not be equal to 11.11%, but will instead be equal to nil, as none of the joint owners directly control any of the voting power in the company in question, despite each joint owner holding 11.11% of the economic interest in the company.

The example set out above was raised for consideration by the Australian Taxation Office (ATO) at the last meeting of the NTLG CGT & Losses sub-committee. At this meeting, representatives of the ATO expressed the view that under the current law, in such a situation, the voting power held by each of the joint shareholders would be nil. At this meeting, the ATO recommended that this issue be forwarded to TIES for consideration by Treasury.

Whilst the Taxation Institute of Australia does not concede that the ATO's view is necessarily the correct interpretation of the current law, in light of the ATO's view being contrary to the intention of the legislation, we would prefer to see a legislative change to resolve this issue.

By way of further example, the single share in a company may be bequeathed by a testator to her three children jointly. On the ATO approach outlined above, the small business participation percentage of each of those children in the company will be nil, despite each of them holding a 33.33% “economic” interest in the company.

By way of background, where such situations occur in practice, the voting power bestowed on the jointly held shares may be bestowed on one or more of the joint holders under:

- a written shareholders agreement; or
- a power conferred by the constitution of the company; or
- under an informal agreement between the joint holders.

However, due to the number of different situations encountered in small business entities, it is impossible to know in how many circumstances this will be the case. It is likely that in the vast majority of cases where shares are jointly held there will be no formal (or even informal) agreement as to which of the joint holders controls the voting power in relation to the shares.

**7. How is this problem affecting you or your clients?**

Taxpayers who satisfy both of the following conditions will be affected:

- Those companies and related shareholders who rely on the definition of significant individual (and, by implication, the definition of CGT concession stakeholder) to satisfy the conditions to access the small business CGT concessions; and
- Where some or all of the shares in the relevant company are jointly held.

On the information available to us, it is not possible to estimate the number of taxpayers affected, nor the tax at risk, in this instance.

**8. Do you have a possible solution to your issue?**

The Taxation Institute of Australia submits that further subsections should be included in section 152-70. We suggest the following amendment.

After subsection 152-70(2) insert:

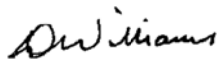
*Jointly held shares*

152-70(3) For item 1(a) in the table, where shares in the company are jointly held each joint holder is deemed to hold that proportion of the voting power in the company equal to the voting power in the company represented by the jointly held shares multiplied by the percentage legal and equitable interest held by that joint holder in those jointly held shares.

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If you require any further information or assistance in respect of our submission, please contact me on 02 9958 3332 or the Taxation Institute's Tax Counsel, Deepti Paton, on (02) 8223 0044 .

Yours sincerely



David Williams  
President