



THE TAX INSTITUTE

6 August 2018

Dr Mark Pizzacalla
Chair
Review of Small Business Tax Concessions
C/- Board of Taxation Secretariat
Treasury
Melbourne Office
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Dear Mr Pizzacalla,

Board of Taxation – Review of Small Business Tax Concessions

The Tax Institute welcomes the invitation to make a submission to the Board of Taxation in relation to its review of the small business tax concessions. In this regard we refer to the Consultation Guide dated May 2018 prepared by the Board of Taxation (**Consultation Guide**).

Summary

The Tax Institute considers that there are two key issues in relation to the small business tax concessions that need to be addressed - a lack of simplicity and efficiency. The complexity in relation to applying the concessions gives rise to high compliance costs and in turn can encourage complex structuring.

We have made some general comments in relation to the small business tax concessions and specifically in relation to the small business CGT concessions below. We have also provided responses to the questions posed in the Consultation Guide where possible.

General Comments

There are a range of matters stemming from the tax system that affect small businesses, such as:

- the appropriateness of current tax policy settings intended to support small businesses, and resulting regulatory requirements; and
- ensuring Australian Taxation Office (**ATO**) practices and procedures do not impose an undue burden on or cost for small business.

Some benefits within the tax law are difficult for small businesses to access due to the complexity of the rules and the prohibitive cost of obtaining sophisticated tax advice to ensure the correct tax outcomes are achieved (for example tax consolidation, share

buy-backs, and certain fringe benefits tax concessions). Further, as discussed below, the various capital gains tax concessions are complex and give rise to attempts to satisfy the eligibility rules resulting in disputes with the ATO.

In order to reform the taxation rules applying to small businesses, there should be a focus on:

- simplifying existing tax laws including in respect of business structures. Where more complex rules are required, make those rules apply to taxpayers that are not small businesses;
- streamlining definitions and access to small business concessions where possible;
- greater harmonisation between small business definitions in State/Territory and Federal tax laws; and
- providing greater resources to organisations such as the Inspector-General of Taxation that assist in identifying areas in which ATO processes and interactions with small business can be simplified.

In this regard, there needs to be balance between the concessions provided for small businesses and the complexity the availability of concessions brings. Redesigning the tax law so that simple base rules apply to all taxpayers, with more complex rules applying to larger businesses, would focus the discussions on simplicity in the first instance and ensure that those who most need that simplicity will be advantaged by it.

Small Business CGT Concessions

The current small business CGT concessions are very complex in nature. These provisions provide an example of the (relatively) simple base rules for CGT being made very complex for small businesses. The provisions are so complex that it is difficult for a small business to confirm that they qualify for a concession under the rules. As such, this area should be a focus for reform.

The original purpose for introducing these concessions was to assist small business owners to prepare for retirement. Many small business owners rely on their small business as a vehicle to fund their retirement absent available resources to put into superannuation because they instead reinvest in their business.

The cost of complying with these rules is very high. Seeking advice on whether the concessions apply can prove too costly for some taxpayers due to the complexity of the rules. The concessions are also a significant area of audit activity, particularly as the ATO audits each time a taxpayer claims one of the concessions.

The rules are intended to provide a tax concession to small businesses, but they have become so complex that taxpayers often find it is not worth their while trying to determine if the concessions apply or find they do not apply.

In light of the above, the policy intent for providing these concessions should be reviewed with a view to simplifying the rules and making them easier to apply and to ensure they operate to provide relief to small business owners as intended. In the

context of any review of these concessions, we do note that the retirement and rollover concessions (or something similar) should be retained.

In the process of simplifying the CGT concessions for small business, consideration should be given to a broad range of options and all options should be fully explored. This includes reconsidering the options outline in Recommendation 17 of the [Henry Review](#). Some options that our Members have put forward for consideration are included in Annexure A.

Consultation Guide Questions - Core questions

1. What tax issues are of particular concern for small businesses?

In our opinion, one of the major tax issues facing small businesses is the complexity and costs associated with satisfying their taxation obligations. Further, the different levels of taxation (State/Territory and Federal) create additional complexity.

A specific tax issue facing small businesses is the confusion about the definition of what is a small business entity. In our opinion, the definition of a small business entity needs to be clarified and harmonised for all tax purposes. This includes a consistent turnover threshold.

2. What do you regard as the most useful or effective small business tax concessions? Why?

Arguably, the most useful concessions are those that are relatively easy to apply and that reduce compliance costs. For example, the concessions in Division 328 that provide for immediate write-offs for items costing below \$20,000.

The Division 152 concessions can be effective if the relevant requirements are met. However, the provisions are very complex which makes it difficult for small businesses to assess their eligibility for the concessions.

The concessions for simplified reporting and compliance are welcomed. These include the simplified BAS reporting requirements, the ability to use the small business superannuation clearing house and the small business car parking concessions for FBT purposes.

3. What opportunities do you see for improving existing small business concessions?

In our opinion, the complexity must be reduced to improve the small business tax concessions. The complexity of the concessions could be reduced by:

- Clarifying and harmonising the definition of what is a small business; and
- Reconsidering the requirements needed to satisfy the small business CGT concessions.

In our view, this could best be addressed by deliberate design of all tax laws whereby the law is designed to be simple, and any complexity only applies to non-small business taxpayers.

4. Which current small business concessions are not working and/or should be removed? Why?

We consider that the CGT concessions in Division 152 are too complex to work efficiently. They should be significantly simplified and more appropriately targeted to assist small business owners' transition to retirement.

5. What ideas do you have for new concessions that could help small businesses?

We refer to Annexure A.

Consultation Questions - Detailed discussion questions

6. Do you agree with the reform principles outlined in this document? Are there any other principles that should be considered? Why?

The Tax Institute supports the six reform principles outlined in the Consultation Guide. The principles should provide balance between the competing objectives of simplicity, efficiency and fairness.

7. Should certain principles be prioritised over others? Why?

Reducing the complexity of the small business concessions should be prioritised. This would allow businesses to focus on their business not tax.

8. What are the objectives of small businesses using a particular legal structure (companies, trusts, partnership, sole trader)?

Asset protection, succession planning and minimising tax as allowed under tax legislation are significant drivers when a business considers its structure.

- 8.1. What are the main objectives businesses have when they seek structuring advice (for example, reducing tax liabilities, succession planning, asset protection, etc.)?

In our opinion, all three would be key drivers to obtaining structuring advice. Additionally, small business taxpayers also seek to minimise compliance costs (which generally means reducing complexity) by obtaining structuring advice.

- 8.2. Relative to other factors, how important is reducing tax liabilities?

Legally minimising tax liabilities can be a driver for most small businesses. The extent to which this is prioritised by a business may depend on where the business is in its lifecycle. For example, businesses which are just starting may be highly focussed on tax reductions whereas more established businesses may be focussed on asset protection and succession planning.

Ultimately, tax is perceived as a cost of doing business just as any other cost incurred in a business. As such, legal minimisation of tax expenses (and minimisation of the cost of complying with tax laws) is a rational behaviour, but not more of a focus than the reduction of other costs.

9. Are small business tax concessions skewed to specific parts of the small business lifecycle? If so, should they be refocused and in what way?

In our opinion, many concessions appear to be focussed towards the later part of the business lifecycle (for example, Division 152). There should be more concessions focussed on the inception stage of the business lifecycle to encourage innovation and growth (for example, concessions for loss utilisation and accelerated depreciation).

10. Generally, tax concessions are broadly based and apply across different sectors of the economy. Should there be small business tax concessions for specific sectors? If so, why?

In our opinion, tax concessions should be applied in the same manner across all sectors. Otherwise, this could lead to more complexity. Further, growth and innovation would effectively only be encouraged in those sectors which have access to the concessions and definitional issues would become prohibitive.

11. Does the small business eligibility criteria (for example, the \$2m turnover threshold for small business CGT concessions) influence you to not want to grow your business?

We agree that this threshold could have a negative impact. Any threshold may lead to some taxpayers seeking to 'cluster' just under the threshold.

- 11.1. Are there alternative mechanisms to phase-out small business tax concessions as opposed to a hard cut-off?

While a phase out is attractive (to prevent hard cut offs between those eligible and those not eligible) the use of phase outs will be a question of what is being phased out, and whether the concession can effectively be phased out.

12. What changes to the tax system would make it simpler and reduce the compliance burden for small business?

In our view, a focus at the design phase of tax policy on simplicity, with complexity only being imposed on larger businesses, would assist.

13. Should the definition of small business for tax purposes be changed? If so, how?

The definition of small business should be harmonised for all tax purposes and made simpler.

14. Does technology make it easier to comply with your tax obligations and access small business concessions? Why or why not?

We agree that technology does make it easier to comply with tax obligations. However, in our opinion, this benefit is being eroded by the increased compliance obligations placed on small businesses.

* * * * *

If you would like to discuss, please contact either me or Tax Counsel, Angie Ananda, on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tracey Rens'. The signature is fluid and cursive, with a long horizontal stroke at the beginning and a large, stylized 'R'.

Tracey Rens
President

Annexure A

As noted above, in the process of simplifying the CGT concessions for small business, consideration should be given to a broad range of options and all options should be fully explored. This includes reconsidering the options outline in Recommendation 17 of the [Henry Review](#).

Some options that our Members have put forward for consideration in relation to the small business CGT concessions are:

1. Indexation of the \$6M net asset test;
2. Shading the reliefs between the existing cap and a higher cap, so that the concession is not all or nothing.
3. Maintaining the concessions, with an eye to tax neutrality, by:
 - i. reintroducing the asset test as a requirement, not an alternative;
 - ii. limit the discount to a certain maximum asset value (and note that this could be combined with the shading in of eligibility);
 - iii. remove the discount entirely, and just keep the superannuation contribution and business rollover provisions.
4. Simplification so that there is (once again) a single standard test for small business tax concessions - ideally the test should be the same for Divisions 152 and 328-G.
5. The significant individual test for discretionary trusts could be deemed to be satisfied if trust holds a family trust election - rather than tracing through distributions of income and capital in order to simplify application.
6. Ideally the active asset Subdivision 152-B exemption claimed by companies should be able to be distributed out of private companies as a non-taxable dividend (at present it can only be done in some circumstances as a liquidator's distribution).
7. Amendment of the "*connected with*" and "*affiliate*" tests in relation to trusts—and make them a "bright line" test to simplify their application.