

Re:Think – Tax Discussion Paper  
Tax White Paper Task Force  
C/- The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [bettertax@treasury.gov.au](mailto:bettertax@treasury.gov.au)

Dear Sir or Madam,

### **Re:Think – Tax Discussion Paper**

Thank you for giving the Office of the NSW Small Business Commissioner (OSBC) the opportunity to comment on the Re:Think Tax Discussion Paper.

The OSBC is focused on supporting and improving the operating environment for small businesses throughout NSW. The role of the OSBC is to:

- provide dispute resolution services;
- deliver quality business advice through Small Biz Connect; and
- speak up for small business within government.

We support the identification of features of the tax system that are unreasonably or unnecessarily hindering or preventing small businesses from pursuing and achieving their commercial goals.

We offer the following comments on matters relevant to the tax discussion paper.

### **Trends in business structure**

The Discussion Paper notes that there has been an increase in the use of companies and trusts in business structures. Broadly speaking, discretionary trusts are seen as providing the greatest tax benefit/savings of all the business forms<sup>1</sup>. This is reflected in the prevalence of discretionary trusts as the preferred trust vehicle: 78% of all trusts are discretionary trusts.<sup>2</sup> The use of discretionary trusts requires small business operators to interact with the complex trust tax provisions found in Divisions 6 and 7A of the *Income Tax Assessment Act 1936* (ITAA 1936). Division 6 has long been considered an area requiring substantial tax reform<sup>3</sup> and the Board of Taxation (BoT) has expressed considerable doubts that Division 7A coherently achieves its policy aims<sup>4</sup>.

<sup>1</sup> Brett Freudenberg (2013) 'Tax on my mind: Advisors' recommendations for choice of business form', 42 *Australian Tax Review* 33, Page 48

<sup>2</sup> ATO Taxation Statistics - Trusts - Table 1 - 2012-2013

<sup>3</sup> <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2011/modernising-trust-income-tax>

<sup>4</sup> Board of Taxation, *Post-Implementation Review of Division 7A of Part III of the Income Tax Assessment Act 1936: Second Discussion Paper*, Canberra, March 2014, page 27



Though trusts require substantial funds to set up and operate<sup>5</sup> the tax benefits/savings, and other benefits of using a trust vehicle, seem to outweigh the costs associated with the ongoing maintenance of a trust structure. Clearly, the tax system has a considerable effect on the choice of business structure for businesses - regardless of size.

As mentioned in the Discussion Paper, other countries have designed entities specifically for small businesses. The use of a similar structure to the 'S-Corporation' in Australia might have a negligible effect due to the fact that Australia has the imputation system to overcome the occurrence of double taxation of company profits (unlike the United States). We would, however, support the creation of a simpler business structure specifically for the small business sector.

Small business operators consider a number of factors when choosing their business structure: asset protection, tax benefits, regulatory burden and succession planning. As such, often a number of layers/business entity types are used to achieve these outcomes (e.g. a trust with a corporate trustee).

We would be strongly supportive of a small business specific entity type that could retain some of the characteristics small business operators look for when choosing their business structure without the need for complex interaction of different business forms. This includes, for example, allowing small businesses to reinvest uniformly taxed profits back into their business. Currently, reinvestment of funds through trust structures can attract the highest marginal tax rate, whereas companies are only taxed at the flat rate of 30%, and can reinvest the remaining 70% into the business.

### **'Non-commercial' losses**

Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997) was introduced in 2000 as a result of the Government's adoption of Recommendation 7.5 of the Ralph's Committee's report, *Review of Business Taxation: A Tax System Redesigned*. Division 35 prevents losses from business activities being offset against other income (i.e. salary) unless: one of the four objective tests are met; the taxpayer comes within the exception; or, the taxpayer is covered by an exercise of the Commissioner of Tax's discretion in relation to that business activity.

Division 35 provides an exception for individuals that have a loss from a primary production business or a professional arts business in a year of income, so long as the total of their assessable income from sources unrelated to primary production or professional arts business is less than \$40,000. Numerous submissions to the BoT's Post-Implementation Review of Division 35<sup>6</sup> advised that either artists should be completely exempted from the operation of Division 35 or the threshold of \$40,000 be increased<sup>7</sup>. At the time BoT advised this was outside the scope of the review.

The threshold of \$40,000 has, since the introduction of Division 35 in 2000, remained unchanged. Individuals in the business of primary production or professional arts are an exception to the application of Division 35 because they 'suffer real hardship to make a living from their professions'<sup>8</sup>. The present value of \$40,000, comparative to the year 2000, is approximately \$60,000 (accommodating inflation).

<sup>5</sup> <http://www.business.gov.au/business-topics/business-structures-and-types/business-structures/trust/Pages/default.aspx>

<sup>6</sup> Board of Taxation, *Post-implementation Review of the Quality and Effectiveness of the Non-commercial Losses Provisions in Division 35 of the Income Tax Assessment Act 1997: A Report to the Treasurer*, Canberra, June 2004

<sup>7</sup> See submissions from, for example, The Australia Council for the Arts and The National Association for the Visual Arts Ltd

<sup>8</sup> Parliamentary Debates, Senate, Vol. No. 9, 29 June 2000, page no. 15989



We support the Government's commitment to a better tax system that delivers taxes that are lower, simpler and fairer. It is questionable whether the benefits the exception will provide to individuals in the business of primary production or professional arts outweighs the time intensive exercise of applying the Division 35 exception, especially as the exception is capped at the unindexed amount of \$40,000. We suggest, at the very minimum, increasing the threshold amount to \$60,000 to reflect inflation since the introduction of Division 35 in 2000.

### **Tax Compliance Costs for small businesses**

Tax compliance costs represent the time, effort and financial costs taxpayers must bear to meet their taxation obligations over and above the cost of keeping records and accounts in the usual course of business.

Australian taxation compliance costs have a more significant impact on small businesses than on larger businesses. They are regressive, with a given cost imposing a proportionately higher impost for smaller businesses. When taxation compliance costs are expressed in relation to each \$1,000 of turnover for Australian businesses, the regressive pattern is clear:

- \$39.05 per \$1,000 for businesses with turnover up to \$1 million;
- \$19.54 per \$1,000 for businesses with turnover of \$1 million to \$3 million;
- \$8.50 per \$1,000 for businesses with turnover of \$3 million to \$6 million; and
- \$6.64 per \$1,000 for businesses with turnover in excess of \$6 million.<sup>9</sup>

There's general acknowledgement that compliance costs have a greater impact on small businesses than on larger businesses. Past governments have implemented tax concessions to produce favourable outcomes which fall into two main categories:

- i) concessions that provide a lower rate of taxation, or accelerated deduction, and
- ii) concessions that excuse the taxpayer from requirements otherwise imposed.

Over half of the time spent by businesses in complying with tax obligations in Australia is spent *recording information* needed for tax. GST administration is the largest single cause of compliance costs, responsible for 58% of internal tax compliance costs<sup>10</sup>.

Previous studies have acknowledged concerns relating to Business Activity Statement (BAS) completion, expressing a finding that 'the BAS is still regarded as the most annoying and time consuming tax compliance requirement for small businesses'<sup>11</sup>. Consideration may therefore be given to BAS format, explanatory materials, and frequency. We wouldn't support any increase in frequency beyond the current quarterly BAS reporting requirement applicable to small businesses.

We support Government efforts aimed at getting tax policy settings right for the small business sector and suggest particular consideration of the second category of concession described above, with any tax rule changes mindful of the benefits of simplicity and clarity of application.

<sup>9</sup> John Hasseldine, Chris Evans, Ann Hansford, Philip Lignier, Sharon Smulders, Francois Vaillancourt, *A comparative analysis of tax compliance costs and the role of special concessions and regimes for small businesses in Australia, Canada, South Africa and the United Kingdom*, National Tax Association Conference Providence, Rhode Island, 6-7 September 2012

<sup>10</sup> Ibid

<sup>11</sup> Board of Taxation, *Scoping study of small business tax compliance costs: A report to the Treasurer*, Canberra, December 2007



## Small business capital gains tax concessions

Division 152 of the ITAA 1997 contains the small business capital gains tax (CGT) concessions, which allows small business taxpayers to reduce the amount of tax payable on capital gains arising from certain CGT events. The small business CGT concessions eligibility rules have two stages: firstly, the small business must satisfy the basic conditions that apply to all four concessions and, secondly, the conditions that apply specifically to each concession.

These rules can be simplified to make them easier to apply by small business operators. 'Australia's Future Tax System Review', initiated by the Rudd Government in 2008, similarly suggested simplifying the CGT regime to reduce administration and compliance costs for small businesses in particular<sup>12</sup>.

The four separate small business CGT concessions are considered an area of high complexity within the CGT regime. The two stage eligibility rules create a maze that many small business operators must navigate, given that these concessions are quite popular for small business operators because of the advantages they provide.

Studies have shown that small business taxpayers do not have a good understanding of the small business CGT concession provisions and are almost entirely reliant on their tax advisors to explain the concessions to them. This adds substantially to their tax compliance costs as even tax advisors themselves find Division 152 provisions difficult to apply:

*This complexity present in the eligibility rules results in the clients having high professional fees due to the amount of time spent by practitioners evaluating their client's position and coming up with a recommendation as to whether the client is able to take advantage of one (or more) of the concessions.*<sup>13</sup>

This complexity within the small business CGT concessions detracts from the policy intent behind the enactment of these provisions and simply adds to the compliance costs small businesses face.

We support the suggestion made in 'Australia's Future Tax System Review' to "rationalise existing concessions, exempt certain assets, simplify the legislative provisions, and remove some grandfathering arrangements"<sup>14</sup>. This will go a long way to delivering a tax system that delivers taxes that are lower, simpler and fairer.

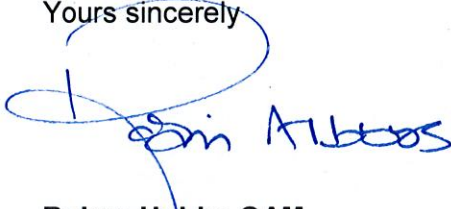
<sup>12</sup> The Australia's Future Tax System Review, 'Australia's future tax system: Report to the Treasurer (Part Two)', Canberra, December 2009, page 78-81

<sup>13</sup> Kerrie Sadiq & Stephen Marsden (2014) 'The small business CGT concessions: Evidence from the perspective of the tax practitioner' 24(1) *Revenue Law Journal* 1, pages 13-14

<sup>14</sup> Some suggestions made to complete this task involve: The active asset 50 per cent reduction and 15-year exemption concessions should be abolished; and, the lifetime limit for the retirement exemption should be increased and taxpayers who sell a share in a company or an interest in a trust should be able to access the concessions via the turnover test.

We appreciate the opportunity to comment on the Re:Think Tax Discussion Paper. Should you wish to discuss any of the issues raised in this submission, please contact Magdalena Kaczmarek, Advisor, Advocacy on (02) 8222 4853.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Robyn Hobbs', with a large, stylized flourish above the name.

**Robyn Hobbs OAM**  
**NSW Small Business Commissioner**

2 June 2015

