



THE TAX INSTITUTE

1 March 2018

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Dear Mr Derlacz

Small Business CGT Concessions

The Tax Institute (**TTI**) welcomes the invitation to make a submission in relation to the measures announced to improve the integrity of the small business capital gains tax (**CGT**) concessions.

These measures are detailed in the following consultation documents:

- *Treasury Laws Amendment (Measure No. #) Bill 2018: improving the small business CGT concessions (Exposure Draft)*; and
- *Treasury Laws Amendment (2018 Measures No. #) Bill 2018 Exposure Draft Explanatory Materials (Explanatory Material)*.

Summary

TTI considers that the Exposure Draft should be substantially redrafted before being enacted. In our opinion, as currently drafted, the Exposure Draft:

- Is overly complex and could be redrafted in a simpler manner;
- Introduces retrospective restrictions on access to the CGT concessions that were not appropriately detailed in the relevant Budget announcements. This will impose costs on taxpayers who have genuinely entered into binding agreements based on how they legitimately thought the law would apply. Therefore, we consider that the date of effect of this legislation should be deferred to when the Exposure Draft was released; and
- It has a distorting effect on how businesses are structured essentially placing a business that is operated through a company at a further disadvantage when compared to any other structure such as a trust or partnership. Further, it disadvantages existing businesses in a company structure when compared to a business operated by a trust.

Further details of TTI's concerns are outlined below.

Detailed comments

In our view, a fair reading of the limited detail in the 2017-18 Budget announcement in relation to these measures (**Budget Announcement**, refer Appendix A) is that the small business CGT concessions were to be amended to prevent access to the concessions where the assets being disposed of were unrelated to the small business which caused the taxpayer to be eligible for the concessions.

Our reading was reinforced by the comments in the Budget Announcement (refer Appendix A) that:

- The concessions would remain available to small business taxpayers (ie the entity making the gain, not the 'object entity') with aggregated turnover of less than \$2m or business assets less than \$6m; and
- The measure was to improve the integrity of the tax system.

However, in our opinion, the amendments outlined in the Exposure Draft go further than expected based on our reading of the Budget Announcement.

These changes introduce unnecessary complexity into Division 152, with a resulting decrease in certainty for taxpayers in assessing whether they have satisfied their taxation obligations.

Our analysis of the amendments in the Exposure Draft is as follows:

Draft provision	Impact	TTI comment
152-10(2)(a)	<p>A share or interest in a company or trust must pass a modified active asset test. The modifications are set out in subsections (2A) and (2B) and effectively:</p> <ul style="list-style-type: none"> • Deem cash and financial instruments not to be active unless held as trading stock; and • Look through lower level entities and only count as active those assets held by CGT concession entities; and • Deem the control percentage to be 20% 	<p>The provisions are complex and self-referential. In our opinion, the proposed legislation will not be easy to understand or apply.</p> <p>The most obvious financial instruments that are currently active assets would be trade debtors which are specifically excluded from being an active asset under the new definition.</p> <p>Section 152-40 was previously amended to recognise that deeming financial instruments and cash used in a business not to be active (unless held as trading stock) was not the correct result. The proposed amendment in the Exposure Draft will have the effect of undoing the previous amendment to section 152-40.</p>

Draft provision	Impact	TTI comment
	<p>rather than 40% for these purposes; and</p> <ul style="list-style-type: none"> Require the taxpayer to be a CGT concession stakeholder in relation to each such entity. 	<p>While some of the outcomes from this new test are within the bounds of the original Budget Announcement, others are not.</p>
152-10(2)(b)	<p>A taxpayer relying on the \$2m turnover test must carry on a business ‘just before’ the CGT event constituting the sale of the shares or interests. This is intended to ensure that the business activities are not ‘remote’ from the disposal.</p>	<p>The proposed amendments may unfairly affect taxpayers who sell a business and then sell related assets (in the same year) by selling shares or interests.</p> <p>The intention of the amendments to the definition of active asset was to allow assets that had been used in a business for at least half their ownership period to be active, whether or not the business was carried on at the time of the disposal.</p> <p>The concern about ‘remoteness’ could be better dealt with by tracing whether the underlying assets involved were used in the business giving rise to eligibility for the concessions.</p>
152-10(2)(c)	<p>The object entity (ie the company or trust which is disposed of) must be carrying on a business just before the CGT event.</p>	<p>The concept of carrying on a business is not one that is necessarily easy to define as recent amendments in relation to corporate tax rates, TR 2017/D2 (which relates to central management and control) and TR 2017/D7 (which relates to the meaning of carrying on a business in the context of section 23AA) show. A more objectively observable test would be preferable.</p> <p>Further, this condition will exclude the sale of units in a unit trust that passively holds business premises which are rented to a ‘connected’ entity. It is unclear why this sale is excluded where a sale of the asset by the trust directly is likely to be eligible for the concessions.</p> <p>Finally, this paragraph does not look through to ‘later entities’. As such, all dormant holding structures will lose access to the concessions for no reason other than the use of a dormant holding entity.</p>

Draft provision	Impact	TTI comment
152-10(2)(d)	The object entity must be a CGT concession entity when the tests are modified to only count the object entity and 'later entities' in which a 20% or greater interest is held.	<p>This amendment significantly limits the availability of the small business CGT concessions where taxpayers hold a one third interest in an active company with net market value of say \$9m in total.</p> <p>For example, assume Taxpayer A has 100% of the shares in an active company worth \$6m (net worth \$6m) versus Taxpayer B with 33% in an active company worth \$9m (net worth approximately \$3m).</p> <p>Assuming no other assets, Taxpayer B has a lower net worth but cannot access the small business CGT concessions. Taxpayer A is worth more and can access the CGT concessions.</p> <p>Many small businesses which have co-investors in order to grow (for example, family businesses and technology businesses) will be adversely affected by the amendment.</p> <p>At present, this holding is covered by the concessions. In our opinion, this change to the eligibility requirement cannot be inferred on a fair reading of the Budget Announcement and is unrelated to the apparent integrity concerns.</p>
152-10(2)(e)	No change to current law	Not applicable

TTI respectfully considers that greater and more focussed detailed information should be included in the Budget and other tax related announcements to allow taxpayers to take into account proposed changes.

We respect that there has to be a balance between acting quickly to address what appears to be an integrity measure versus drafting a targeted focused and fully considered announcement. We also recognise the resource and time constraints placed on Treasury.

However, we ask the Government to consider shifting the balance more towards providing detailed tax policy announcements rather than trying to announce a tax change in a short time frame without at least a descriptive statement of the behaviour the Government is seeking to address.

By doing so, we maintain that it would assist the Parliamentary draftsman by providing them with a detailed set of parameters and framework in preparing exposure draft legislation. Clearer focused legislation would also reduce compliance costs for taxpayers seeking to comply with the Government's policy.

To illustrate our point regarding more detail being required consider the following: paragraph 1.24 of the Explanatory Materials refer to a 20% ownership stake as the test for a holding being "essentially passive". This is different to the 10% non-portfolio interest test found elsewhere in the *Income Tax Assessment Act 1997*. Whereas at paragraph 1.29 of the Explanatory Materials, a 20% stake is deemed to be effective control of an entity.

Alternative approach

An alternative approach that would deal with the integrity concerns fairly flagged in the Budget Announcement without negatively affecting a large number of taxpayers who (it would appear) are inadvertently adversely affected by the Exposure Draft is as follows:

- In assessing whether shares or interests are active assets for a taxpayer relying on the \$2m turnover test, only count assets of the object entity (and any 'later' entity) as active to the extent that they are inherently connected with a business carried on by the taxpayer. This would be similar to the approach in 152-40(1)(b).; and
- For all purposes, interests in a 'later' entity cannot be active unless an aggregate interest in that entity of at least 20% is held by the object entity and its connected entities and affiliates.

In our opinion, the Government's integrity concerns can be dealt with by implementing these two amendments without requiring any other amendments.

Such an approach would deal with the integrity concerns raised in the examples in the Explanatory Materials while preserving the concessions in circumstances where they are clearly intended to be available. We also consider that such amendments would be able to be drafted in a simpler manner than those currently included in the Exposure Draft.

Date of effect

As outlined above, we consider that the Budget Announcement did not provide enough detail about the proposed amendments. As a result, taxpayers will have made decisions about their arrangements (including disposals of shares and interests) since 1 July 2017 based on assumptions on how the Budget Announcement would be implemented.

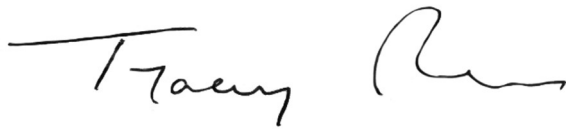
Some actions taken based on those assumptions will not be able to be changed without significant consequences. In particular, where contributions have been made to superannuation funds under the concessions in Subdivisions 152-B or 152-D, it will not be possible to change such decisions.

We consider that the date of effect of this legislation should therefore be deferred to 8 February 2018 when the Exposure Draft was released.

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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 written in a cursive style with a long horizontal line above the first name.

Tracey Rens
President

APPENDIX A

BUDGET ANNOUNCEMENT

“Tax Integrity Package — improving the small business capital gains tax concessions

Revenue (\$m)

	2016-17	2017-18	2018-19	2019-20	2020-21
Australian Taxation Office	-	-	*	*	*

The Government will amend the small business capital gains tax (CGT) concessions to ensure that the concessions can only be accessed in relation to assets used in a small business or ownership interests in a small business. This measure will take effect from 1 July 2017. This measure is estimated to have an unquantifiable gain to revenue over the forward estimates period.

The concessions assist owners of small businesses by providing relief from CGT on assets related to their business which helps them to re-invest and grow, as well as contribute to their retirement savings through the sale of the business. However, some taxpayers are able to access these concessions for assets which are unrelated to their small business, for instance through arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions.

The small business CGT concessions will continue to be available to small business taxpayers with aggregated turnover of less than \$2 million or business assets less than \$6 million.

This measure will improve the integrity of the tax system and ensure that these concessions are appropriately targeted.”