

3 August 2018

Mr Michael Atfield  
Secretary  
Board of Taxation  
Level 6, 120 Collins Street  
MELBOURNE VIC 3000



**Business SA**  
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and Industry South Australia

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Working for your business.  
Working for South Australia

Dear Mr Atfield

I write in response to your request for submissions to the Board of Taxation (the Board)'s Review of Small Business Tax Concessions.

### Executive Summary

- Business SA is concerned about the unintended consequences of changes to the small business capital gains tax concession, particularly impacts on genuine collaborative investments which may be realised if the TREASURY LAWS AMENDMENT (TAX INTEGRITY AND OTHER MEASURES) Bill 2018 is passed without necessary amendments
- The Board's review should consider all thresholds for small business tax concessions across Australia, including state taxes such as payroll tax which differ in their concessions for smaller businesses, including for businesses in metropolitan and regional areas
- There is a sound basis for a less complex and lower tax structure to incentivise the growth of small businesses, but this has increasingly come at the expense of keeping businesses small; which Australia cannot afford to do in an increasingly competitive global trade environment
- The increasing disparity of eligibility thresholds for small business tax concessions is actually adding complexity for small business owners which comes at a cost and limits their ability to understand how to best structure their tax affairs to maximise the growth of their business and meet other objectives such as retirement planning.

Should you require any further information or have questions, please contact Andrew McKenna on (08) 8300 0000 or [andrewm@business-sa.com](mailto:andrewm@business-sa.com).

Yours sincerely,

Anthony Penney

Executive Director, Industry and Government Engagement





### Why this matter is important to South Australian businesses

*As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:*

- 97.6% of businesses in South Australia are considered small, i.e. employing less than 20 people, and ensuring the tax system adequately incentivises their growth is critical to our State's broader economic prosperity.
- Recent changes introduced into Parliament to the small business capital gains tax (CGT) concession have caused considerable angst amongst South Australia's business community, particularly given a lack of extensive consultation and a proposed retrospective date application.
- Amendments to thresholds related to small business tax concessions have repeatedly changed in recent years and while those changes are often aimed at increasing the reach or effectiveness of particular concessions, consistent change in this area of tax law also brings with it complexity and cost when changes create differing eligibility levels across various small business tax concessions.
- Established in 1839, Business SA has always stood for the growth of businesses, and small business tax concessions must always be carefully considered so as not to create artificial barriers to growth, particularly considering businesses with between 20 and 200 employees are currently the fastest growing employers in Australia.

### Key Policy Points

1. Company tax and payroll tax are the two taxes of most concern to South Australia's business community, and while reform in these areas is most likely beyond the scope of the Board's review, there should be consideration to the fact that Australia as a whole needs to move to a simpler, fairer and more efficient tax system which ultimately incentivises capital investment on an equal footing to employment. Furthermore, a review of Federal small business tax concessions cannot ignore the myriad of payroll tax incentives around Australia, many of which are targeted to improve the tax burden on small businesses but which act collectively to create a complex web of different rates and thresholds, including for apprentices and regional areas. Knowing that many of our most successful members look to expanding interstate as an obvious step to growth, it is surprising that differing thresholds for payroll tax are not given more attention from a Federal tax policy perspective.

Ultimately, Business SA reiterates our long-held view that Australia should be moving towards a tax structure where a broadened or increased rate of GST eventually replaces payroll tax. Considering payroll tax is levied regardless of profitability, this would also help with improving the cash flow position of small to medium sized businesses and aligns with the Board's second principle for reform.



2. In terms of the specific importance of various small business tax concessions to South Australia's SME community, the capital gains tax incentive is most commonly utilised, along with the temporary \$20,000 instant asset write-off provision.

While not as commonly used, the refundable R&D tax offset is also quite important, particularly to businesses trying to innovate and develop new knowledge, leading to new and improved products and services. For a State in the midst of a structural transition post the closure of local auto-manufacturing, these types of incentives play a critical role in enabling the experimentation required for businesses to diversify.

3. As per the range of small business concessions outlined in your consultation paper, there are various levels of eligibility, albeit most are centred around the \$10 million revenue threshold following adjustments at the time businesses below this threshold received company tax cuts. During the initial consultation stage of the 2016 Enterprise Tax Plan Bill, Business SA lobbied to keep the small business concession levels aligned by lifting all to the \$10 million threshold level. At the time we were concerned about introducing additional complexity to small business tax arrangements by not aligning thresholds for small business tax concessions. This remains a relevant consideration and we recommend the Board consider how to ensure Australia moves back towards alignment to avoid unnecessary complexity in future, bearing in mind it is the small businesses themselves who pay for this complexity through having to procure more advice to navigate optimal structures with differing thresholds.
4. With the range of thresholds applying to various concessions or treatment of small businesses, it becomes difficult around the end of a financial year for business owners to assess what rates will apply to them. Businesses do not shut down on 30 June and re-open on July 1, and it is important for there to be consistency in this area to provide more clarity to small business owners as to the likely impact of their business growth on tax treatment.
5. Business SA has recently raised concerns about the TREASURY LAWS AMENDMENT (TAX INTEGRITY AND OTHER MEASURES) BILL 2018 tightening eligibility for genuine small business owners accessing the CGT concession. This also stems from the fact that the initial consultation on the exposure draft was released nine months after the 2017/18 Budget announcement, and lasted for less than three weeks. Furthermore, the Budget papers did not outline a monetary impact of this particular measure, and it was not considered by the business community more broadly to constitute a material change to the existing arrangements in place since 1999.

A significant issue with the Bill as currently drafted is that it provides a disincentive for collaborative investments. Consider the following scenario:

- Shareholder A owns 20% of the ordinary shares in a company;
- Shareholder A has net assets of less than \$6 million (for the purposes of the maximum net asset value test ("MNAVt")); and
- the company has an aggregated annual turnover exceeding \$2 million and net assets (for the purposes of the MNAVt) of more than \$6 million (for illustrative purposes, say \$25 million).

The existing legislation would not preclude Shareholder A from disposing of its shares and claiming the small business CGT concessions. Under the Bill, however, Shareholder A would no longer qualify for relief based on the company's assets and turnover.



This is the result notwithstanding that the value of Shareholder A's shares is only \$5 million and Shareholder A satisfies the \$6 million MNAVt. If Shareholder A instead owned 100% of an entity with net assets of \$5 million, it would be possible for Shareholder A to qualify for the relief. This is clearly an anomalous result. We consider that the above result discourages collaborative business efforts amongst small to medium sized enterprises, the engine room of our economy.

Our members' discussions with Treasury suggest that the only mischief that the Bill is intended to address is where a shareholder in a company with significant assets and turnover does not satisfy the MNAVt but qualifies for the small business CGT concessions under the \$2 million turnover test. This might be achieved where a shareholder carries on a business in their own right that has a turnover not exceeding \$2 million and that is entirely independent of the business of the object company; essentially, taxpayers starting unrelated small businesses to access the concessions. However, the proposed changes go too far and include taxpayers who should sit outside the group of taxpayers the Government wants to tighten integrity measures for. While there may be outcomes under the existing law which are inequitable, the proposed changes punish the many for the sins of the few.

Business SA considers that any existing mischief could be easily overcome, without creating a disincentive for collaborative investments, by requiring that the shareholder satisfies the MNAVt and cannot rely on the \$2 million turnover test to access the small business CGT concession. In our view, this would be a simple way of addressing the mischief without creating unintended consequences. Without amendment, the Bill will result in cases where genuine small business investors who have collaborated to form a company may not be able to access the CGT concession in future if their combined net assets exceed the \$6 million threshold.

In one live experience for a Business SA member, 4 business owners have bootstrapped and grown a company business over the last 10+ years, employing approximately 30+ people in Australia. The business is now worth somewhere in the order of \$7-10 million with annual revenues of \$7-8 million. Each of the 4 owners has a 25% interest in the company. The owners have made financial decisions throughout the entire life span of the business to reinvest in the business as opposed to extract personal wealth. They each have taken a modest salary (\$60-\$80,000) in order to support the business as opposed to higher executive salaries.

They have also invested in the capital of the business and helped stimulate the economy through doing so. They have carried on their financial decisions based on the tax consequences that if and when they exit via a sale, they would be (and should be) entitled to access the small business CGT concessions. Their shares in the business are the only material asset of each owner apart from their main residence. They all easily satisfy the \$6m MNAVt. Their investment represents their retirement nest egg.

Under the previous, existing small business CGT concessions, these small business taxpayers would be rightly entitled to access the concessions – their assets are less than \$6 million, their CGT asset is an active asset, and they are CGT concession stakeholders. Unfortunately under the Bill, they would not be entitled to access the concessions because the 'object entity' is valued at more than \$6M. This is notwithstanding that each of their respective interests is only 25% of that value.

In this live example, the proposed legislation would result in an additional \$2 million in capital gains tax payable for these small business taxpayers. This should not be the result, simply due to inadequate crafting of the proposed legislation.



6. Business SA welcomed the recent extension of the \$20,000 instant asset write-off provision for small business after the measure was first introduced in the 2015/16 Federal Budget for two years, and subsequently extended in 2017 for 12 months. While this provision provides a very direct way in which to incentivise small businesses to invest in income producing assets, given it was initially introduced for a limited period which has now been extended twice, there is a growing sense that it has become a permanent fixture of the tax system. Consequently, in the Board's deliberations about the appropriateness of this threshold in a more permanent tax structure, it should also consider that several policy decisions both to introduce and extend the policy need to be accounted for in terms of changes which may have adverse impacts on the way in which small businesses perceive the tax system operating in a consistent fashion.
7. Business SA supports the Board's argument that tax concessions involve a significant commitment of public funds and the community expects that they will be administered responsibly, be enjoyed only by their intended recipients, and go only as far as necessary for them to meet their policy objectives.

We also agree that assistance to small business should, as far as possible, avoid the creation of distortions or complexities in the tax system, so that that business decisions are motivated by commercial, rather than tax, considerations. Judgments need to be made in weighing up these competing priorities.

Business SA often raises concerns about 'cliff' issues in the system distorting the decisions of small business owners, particularly in relation to taxes such as payroll tax. As an organisation that primarily represents small to medium sized businesses, we do not subscribe to tax structures which act to keep our members small. We are interested in helping businesses willing and able to grow to realise their aspirations and to benefit our society more broadly. Accordingly, Business SA argues that small business tax concessions should be structured to enable small businesses to grow, rather than incentivising them to remain small. Specifically in relation to your fourth principle of reform, we recommend it be expanded to reflect the latter point.

8. Considering only 37% of businesses operate under a company structure<sup>1</sup>, the Board should also consider the impact of personal income tax relief for small businesses, particularly in relation to the effectiveness of the unincorporated small business tax discount. Personal income tax cuts have been raised as a key issue for Business SA members, but awareness of the unincorporated small business tax discount seems very low and the Board needs to consider what is the most effective vehicle to incentivise unincorporated business growth.
9. Business SA would not support special tax treatment of specific sectors which would only invite Government policy to pick winners, or support sectors which should otherwise have to stand on their own feet. The reality of our existing system is that we have already moved too far in the directly of complexity with various thresholds for small business tax concessions, and specific sector concessions would only complicate matters further. Business SA's view does not extend to arguing that genuine tax variations for industry specific rationale are inappropriate, for example it is reasonable that fuel tax credits rebates be in place to reflect the majority of agricultural and mining fuel use occurring off public roads.

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<sup>1</sup> ABS, Counts of Australian Businesses (including entries and exits) June 2013 to June 2017, catalogue no.8165



10. Considering residential property is a very important enabler of small business financing, the Board should consider including a section in its report which highlights that negative gearing is actually just part of the standard operation of the tax system, enabling deductions in the process of earning income. Business SA is mindful that future changes to the tax system based on property prices in Sydney and Melbourne could have far reaching consequences across Australia, including for South Australian businesses, and we recommend better public information about the fundamental operation of the tax system, and the logic behind the need for deductible expenses. Commerce does not occur and economies do not grow if individuals and businesses do not take measured risks to earn income, and the tax system needs to continue to support them in doing so.