From:	Tony Evans
To:	Flego, Adrian
Cc:	Atfield, Michael; Tax Board
Subject:	FW: Board of Tax_Invitation for discussion on Small business tax concessions [SEC=UNCLASSIFIED]
Date:	Monday, 23 July 2018 12:04:47 PM
Attachments:	image001.png image004.png

Hi Adrian,

I have updated my list of recommendations with some additional comments and explanations as a result of the meeting on 19th July and it is included below. The additional comments / add ins are in red so you can easily identify them.

SUBMISSION RE REVIEW ON SMALL BUSINESS CONCESSIONS

Whilst not a detailed submission, we have put together a summary of our suggestions and concerns in relation to accessing small business concessions to assist in the discussion at our meeting on 19th July, 2018. This has been updated in red for thoughts / comments arising as a result of the meeting. You are welcome to contact me on my mobile should you wish to discuss these matters further.

ISSUES AND CONCERNS

- The law is overly complicated and difficult to understand and apply
- Significantly different outcomes can arise for different types of entities
- The grouping rules are inconsistent across various regimes with different rules for FBT compared to SBE compared to CGT Small Business Concessions
- The grouping rules are overly complex and almost unintelligible
- There are numerous different thresholds for different concessions
  - $2 million grouped turnover for CGT Small Business Concessions
  - $6 million asset grouped threshold for CGT Small Business Concessions
  - $5 million grouped turnover threshold for SBE tax rebate
  - $10 million grouped turnover threshold for most SBE concessions
  - $10 million ungrouped turnover threshold for FBT carparking exemption
- The asset threshold test for CGT Small Business Concessions is totally irrelevant in determining whether a business is a small business.
- The complexity means that taxpayers who plan well in advance of the concession access date are placed at a significant advantage to taxpayers who fail to plan over the lifetime of the business.
- Assets can remain active assets for an inordinate amount of time after the business has ceased.
- There are no phase in and phase out rules making access to the concessions very arbitrary for businesses near the thresholds.
- The names of some concessions must be modified to reflect the actual benefit of the concession – the Small Business Retirement Exemption now has nothing to do with retirement and the Small Business Small Business 15 Year Exemption requires retirement.

COST AND USE OF RESOURCES

The ATO and taxpayers spend an inordinate amount of time and resources on these concessions and the ramifications of getting them wrong are significant. Taxpayers inevitably require specialist advice and usually will require advice not just from a registered tax agent but also from a registered financial planner.

The ATO runs numerous cases on the application or miss-application of these concessions because there are significant tax dollars involved and the legal complexity means that technical interpretations are still being tested.

The audit focus time spent by the ATO is probably out of proportion on a resource allocation basis with the tax dollars at risk.

POLITICAL RAMIFICATIONS

There will always be winners and losers when significant changes are made and some changes will be popular and some unpopular. This should not be an impediment for logical simplification of law.

Whilst we applauded many of the changes made in 2006 and 2007 as a result of an earlier Board of Taxation Review, they had the effect of complicating the law to the point that some sections are now almost unintelligible. This must be avoided under this review.

MATTERS WHICH SHOULD NOT BE ADDRESSED IN THIS REVIEW

Several matters were raised in the meeting on 19^{th} July, which we believe should be excluded completely from this review: -

- PSI flow through issues. PSI should end up in the hands of the individual generating the income regardless of whether they conduct a business or not. It is not a small business concession issue but a taxation liability issue. It is a separate can of worms!
- Special type of look through companies should be considered for small businesses. These would allow the pass through of dividends without additional tax. There are numerous reasons why this suggestion should be dismissed: -
    - You need to differentiate between passive income and business profits
    - You are providing differential concessions to one type of entity compared to others
    - There will be issues with ownership – will the owners need to be individuals?
    - You will see a mass migration of small taxpayers to these entities

RECOMMENDATIONS

General

We suggest a complete rewrite of the CGT Small Business Concessions. Division 152 should be repealed and replaced with new Division 153 so taxpayers and advisors will not be trying to sort through a maze of different commencement dates etc. re law changes. Effectively it is a fresh start.

If a radical change to the CGT Small Business Concessions is made (amongst other concessions), the changes should be prospective - say for CGT Events occurring on or after the first financial year after date of assent. Old rules and new rules could run concurrently for 12 months as an alternative. This allows time for advisors to prepare and for deals being negotiated to access the old concessions under the old rules. This stops the need for complex transitional rules and potential mis-understandings in relation to which law applies.

Removal of Commissioner discretions from the legislation for small businesses. Technically these must be applied for and not self-assessed and virtually no one does this. They lead to uncertainty and the rules should be as prescriptive as possible and reasonable.

CGT Small Business Concessions

- The $6 million asset threshold is abolished. It has no real relevance as whether a business is small or not. This will stop partners in high turnover businesses from accessing the concessions as we would argue and suggest the turnover threshold applies regardless of the stake held in the entity.
- The turnover threshold is made uniform for all concessions. We recommend $10 million but note it may need to be reduced to $5 million or some figure in-between depending on the Treasury forecasts of the taxation impact of these changes. The current measurement of turnover is reasonable in our view: -
    - Prior year turnover
    - Actual current year turnover
    - Reasonable estimate at commencement of year / business provided not over threshold in prior two years.
- You could consider a taxable income threshold as well but as business performance can fluctuate from year to year and cause so interesting outcomes, this is probably too hard to safely implement. Taxpayers could deliberately have a bad year to access the concessions. If a profit threshold was to be considered it would need to be based on highest taxable income in prior 4 years or something similar.
- Taxpayers are allowed a maximum four-year period from the end of the year in which the business has ceased or has been sold to sell any remaining active assets and access the CGT Small Business Concessions on those assets. The period can be less if the asset was active for a lesser period prior to the business sale date. This restricts the ability to benefit from massive capital gains arising during the period it was not used in the business

but still provides a reasonable period to realise the asset.

- The grouping rules are made prescriptive: -
  - Spouses and children under 18 years of age or in a financial dependency arrangement are automatically deemed to be connected entities and are defined to be part of a "Close Family Group".
  - The affiliate definition is removed – it is almost redundant anyhow and usually only catches family members as business relationships are generally ignored.
  - A 40% or more stake test based on a "Close Family Group" ownership is introduced instead of affiliates.
  - Removal of the under 50% tiebreaker test. Discretions are difficult and lead to uncertainties. If there is only a turnover test, then this will not cause distortions currently apparent with counting assets even though the entity is not controlled by you.
  - Otherwise, retain the connected with an entity test – 328-125
- Remove access to the CGT Small Business Concessions for related party transactions in relation to business sales. These should now be covered by SBE Restructure rollover in any event.
- Increase the Small Business Retirement Exemption to a $1 million individual life time limit.
- Abolish the Small Business 50% Reduction and the Small Business 15 Year Exemption.
- Cap the maximum Small Business Concession claim from any one CGT Event at $4 million.
- Allow Significant individuals to be determined by nomination in the taxpayer entity and cap the number at four in the year of the CGT Event and remove the complex tracing rules for small business concession stakeholders. Safeguards can be put in that they must also directly or indirectly have an interest in the entity via ownership interests or beneficial entitlements in that year. Completely abolish the concept of CGT concession stakeholder.
- Allow a phase out of the CGT Small Business Concessions proportionally for turnovers over the threshold at 10% per $100,000. We see no easy way of phasing in or out the other concessions and the law should remain the same for those concessions.
- Allow the small business rollover concession to be allocated to Significant Individuals (as effectively redefined above) so they can acquire eligible replacement assets in place of the taxpaying entity.

Small Business Entity Regime

- Consistent thresholds for all concessions with consistent grouping rules similar to those listed above.
- Allow the small business rebate to pass through several trusts by capping the concession amount to a rebate of $5,000 in total and $1,000 per individual taxpayer and allowing a nomination of the rebate in the top trust based on traced through distributions
- Forbid SBE restructure rollovers to the same type of entity (company to company, discretionary trust to discretionary trust, unit trust to unit trust etc.). This will also curtail and will avoid legitimising phoenixing arrangements to avoid past liabilities and risks from warranty claims, defective materials etc.
- Allow SBE restructure rollovers to entities owned by discretionary trusts provided the correct FTE elections are put in place: -
  - Family trust to either a company or unit trust owned by the same family trust
  - Partnership of individuals to a partnership of trusts (in same proportions)
  - Partnership of discretionary trusts to a unit trust owned by discretionary trusts with matching FTEs in the same proportions

  Currently the rules require a trust to directly own the asset either before or after the rollover and technically the above rollovers and similar rollovers do not work according to the ATO / Treasury / strict letter of law
- Removing the old concessional cash method of accounting rule under the STS rules which can still apply to businesses who were in STS prior to 1st July, 2005 and remained STS / SBE ever since so all business taxpayers just comply with TR 1998/1
- Abolish the trading stock movement concession. It is not worth the cost and every taxpayer should count their stock to determine their profit in any event.
- The prepayment rules should be retained. There is no real tax benefit to making prepayments unless there is a change in tax rates from one year to the next. However, it saves on messy accounting allocations between years and save significant administration

FBT Concessions

- Extend the grouping rules to the car parking concession so they are consistent with the recommendations made above.

- Simplify the car parking small business concession rule to any car parking paid for and incurred by the employer including those in public car parking stations

Other

- No business or passive income test on company tax rate – make it purely a turnover test.
- Recognise that lower company tax rate does not assist taxpayers who spend all of the profits and therefore pass them out and therefore allow the pass through business tax rebate to apply to companies as well.
- Debt / Equity – transitional carve out is only for at call loans and should be extended to other loans
- $20 million turnover test for Debt / Equity transitional rules should be extended so drop below, again have access.
- Add a same or similar business test to the trust loss provisions for ordinary fixed trusts where the stake test or alternative to the stake test are both failed or cannot be passed (as applicable to enable losses to still be recouped where the business continues on.
- Allow taxpayers to determine their trust is a fixed trust if it is unitised and provided any discretions or choices to apply income, capital or voting different to the unit interests have never been exercised.

Regards

Anthony Evans

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From: Flego, Adrian <Adrian.Flego@treasury.gov.au>
Sent: 12 July 2018 10:18 AM
To: 'Tony Evans' <tony@justtax.com.au>
Cc: Atfield, Michael <Michael.Atfield@TREASURY.GOV.AU>; Tax Board <TaxBoard@TREASURY.GOV.AU>
Subject: RE: Board of Tax_Invitation for discussion on Small business tax concessions [SEC=UNCLASSIFIED]

Tony,

Thank you for this, much appreciated. Look forward to meeting next Thursday.

Best,

Adrian Flego

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From: Tony Evans [mailto:tony@justtax.com.au]
Sent: Thursday, 12 July 2018 9:49 AM
To: Flego, Adrian
Cc: Atfield, Michael; Tax Board
Subject: RE: Board of Tax_Invitation for discussion on Small business tax concessions [SEC=UNCLASSIFIED]

Hi Adrian,

I have put some thoughts together in relation to the Board of Taxation review into small business concessions in preparation of the meeting on 19th July, at 9.00AM and they are set out below in bullet point. This is just a quick dump of ideas I put together when I had 30 minutes spare.

SUBMISSION RE REVIEW ON SMALL BUSINESS CONCESSIONS

Whilst not a detailed submission, we have put together a summary of our suggestions and concerns in relation to accessing small business concessions to assist in the discussion at our meeting on 19th July, 2018.

ISSUES AND CONCERNS

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- The complexity means that taxpayers who plan well in advance of the concession access date are placed at a significant advantage to taxpayers who fail to plan over the lifetime of the business.
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- The names of some concessions must be modified to reflect the actual benefit of the concession – the Small Business Retirement Exemption now has nothing to do with retirement and the Small Business Small Business 15 Year Exemption requires retirement.

COST AND USE OF RESOURCES

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The ATO runs numerous cases on the application or miss-application of these concessions because there are significant tax dollars involved and the legal complexity means that technical interpretations are still being tested.

The audit focus time spent by the ATO is probably out of proportion on a resource allocation basis with the tax dollars at risk.

POLITICAL RAMIFICATIONS

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RECOMMENDATIONS

General

We suggest a complete rewrite of the CGT Small Business Concessions. Division 152 should be repealed and replaced with new Division 153 so taxpayers and advisors will not be trying to sort through a maze of different commencement dates etc. re law changes. Effectively it is a fresh start.

CGT Small Business Concessions

- The $6 million asset threshold is abolished. It has no real relevance as whether a business is small or not.
- The turnover threshold is made uniform for all concessions. We recommend $10 million but note it may need to be reduced to $5 million or some figure in-between depending on the Treasury forecasts of the taxation impact of these changes.
- Taxpayers are only allowed a maximum four-year period from the end of the year in which the business has ceased or has been sold to sell any remaining active assets and access the CGT Small Business Concessions on those assets. The period can be less if the asset was active for a lesser period prior to the business sale date. This restricts the ability to benefit from massive capital gains arising during the period it was not used in the business but still provides a reasonable period to realise the asset. It also means that it links back to the turnover test in the business sale year and not to an asset threshold test.
- The grouping rules are made prescriptive: -
    - Spouses and children under 18 years of age or in a financial dependency arrangement are automatically deemed to be connected entities and are defined to be part of a family group.
    - The affiliate definition is removed – it is almost redundant anyhow and usually only catches family members as business relationships are generally ignored.
    - A 40% or more stake test based on family group ownership is introduced instead of affiliates.
    - Removal of the under 50% tiebreaker test.
    - Otherwise, retain the connected with an entity test – 328-125
- Remove access to the CGT Small Business Concessions for related party transactions in relation to business sales. These should now be covered by SBE Restructure rollover in any event. This stops wash transactions.
- Increase the Small Business Retirement Exemption to a $1 million individual life time limit.
- Abolish the Small Business 50% Reduction and the Small Business 15 Year Exemption.
- Cap the maximum Small Business Concession claim from any one CGT Event at $4 million or some other similar figure.
- Allow Significant individuals to be determined by nomination in the taxpayer entity and cap the number at four in the year of the CGT Event and remove the complex tracing rules for small business concession stakeholders. Safeguards can be put in that they must also directly or indirectly have an interest in the entity via ownership interests or beneficial entitlements in that year. This could be a generic clause rather than the complex rules we have at the moment. Completely abolish the concept of CGT concession stakeholder and the overly complex trace through rules.

- Allow a phase out of the CGT Small Business Concessions proportionally for turnovers over the threshold at 10% per $100,000 over the threshold. We see no easy way of phasing in or out the other concessions and the law should remain the same for those concessions.
- Allow the small business rollover concession to be allocated to Significant Individuals by nomination (as effectively redefined above) so they can acquire eligible replacement assets in place of the taxpaying entity.

Small Business Entity Regime

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- Allow SBE restructure rollovers to entities owned by discretionary trusts provided the correct FTE elections are put in place: -
    - Family trust to either a company or unit trust owned by the same family trust or a related FTE family trust
    - Partnership of individuals to a partnership of trusts (in same proportions)
    - Partnership of discretionary trusts to a unit trust or company owned by discretionary trusts with matching FTEs and in the same ownership proportions

  Currently the rules require a trust to directly own the asset either before or after the rollover and technically the above rollovers and similar rollovers do not work according to the ATO / Treasury / strict letter of law
- Removing the old concessional cash method of accounting rule under the STS rules which can still apply to businesses who were in STS prior to 1st July, 2005 and remained STS / SBE ever since so all business taxpayers just comply with TR 1998/1. Most advisors fail to appreciate this old rule still technically applies and has a different method of accounting on a cash basis and adjustments on conversion to accruals.

FBT Concessions

- Extend the grouping rules to the car parking concession so they are consistent with the recommendations made above.
- Simplify the car parking small business concession rule to any car parking paid for by the employer including those in public car parking stations (but not reimbursements)

I hope these all make sense and will assist in the discussions. I can elaborate further on these if required at the meeting and possibly before hand if I find time and you have any questions.

Regards

Anthony Evans

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From: Flego, Adrian <Adrian.Flego@treasury.gov.au>
Sent: 6 July 2018 9:43 AM
To: 'tony@justtax.com.au' <tony@justtax.com.au>
Subject: Board of Tax_Invitation for discussion on Small business tax concessions [SEC=UNCLASSIFIED]

Dear Tony,

Thanks for your expression of interest in attending a roundtable discussion on the tax concessions for small business. I can't quite recall when you said you were back from Tasmania. However, to support our review, we would encourage you and your colleagues to attend at the time proposed below in Melbourne if you can make it.

The Board's review is being undertaken in response to feedback from the business community that there is scope for significantly improving the way that tax concessions can help small businesses and positively contribute to the broader economy. Whilst certain concessions are highly valued by small business, others are thought to be outdated, poorly targeted or too difficult to understand and/or access. The perennial challenge is to provide concessions that are efficiently targeted to where they are most likely to achieve the goals originally ascribed by policymakers and politicians enacting the measures.

Please respond via return email or alternatively, contact me on either number below.

Thursday 19 July 2018	**Melbourne**	**The Treasury, Level 6, 120 Collins Street Melbourne**	**9:00am – 10:00am**

Look forward to hearing back from you.

With best regards,

Adrian Flego

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