Australian Chamber of Commerce and Industry

CGT CONCESSIONS FOR SMALL BUSINESS

SUBMISSION TO THE BOARD OF TAXATION

APRIL 2005

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1 Background

The Australian Chamber of Commerce and Industry (ACCI) is the peak council of Australian business associations. ACCI's members are 36 employer organisations in all States and Territories and all major sectors of Australian industry. A list of ACCI's membership is attached.

Through our membership, ACCI represents over 350,000 businesses nation-wide, including the top 100 companies, over 55,000 enterprises employing between 20-100 people, and over 280,000 enterprises employing less than 20 people. This makes ACCI the largest and most representative business organisation in Australia.

Membership of ACCI comprises State and Territory Chambers of Commerce and national employer and industry associations (a list of members is attached). ACCI members are representative bodies for small employers or sole traders, as well as medium and large businesses.

2 Introduction

2.1 Background to the Review

The Board of Taxation is undertaking a post-implementation review of the Capital Gains Tax (CGT) concessions for small business. The review is to assess the 'quality and effectiveness' of the legislation. The terms of reference for the review are:

> The Board will assess the quality and effectiveness of the small business CGT concessions and will have regard to the extent to which the legislation:
>
> - gives effect to the Government's policy intent, with compliance and administration costs commensurate with those foreshadowed in the Regulation Impact Statement for the measure;
> - is expressed in a clear, simple, comprehensible and workable manner;
> - avoids unintended consequences of a substantive nature;
> - takes account of actual taxpayer circumstances and commercial practices;
> - is consistent with other tax legislation; and
> - provides certainty.

2.2 CGT Concessions for small business.

Small business has access to the general Capital Gains Tax (CGT) discount as well as a range of specific small business concessions and rollovers. In 1999, the Government introduced a general 50 percent CGT exemption for assets held for more than one year.

For small business, the Government replaced the 50 per cent CGT exemption for goodwill with the following concessions:

- A 50 percent discount for active assets (this is in addition to the general 50 percent exemption, meaning that there is a 75 percent reduction for active assets);

- Rollover relief, allowing businesses to roll any remaining CGT liability into replacement assets; and
- A full (100 percent) CGT exemption of up to $500,000 for retiring small business owners.

To be eligible for these capital gains concessions a business must pass the following tests:

- the maximum net asset value test which requires the business entity and related entities to own less than $5 million in total net value of CGT assets when the GCT event occurs;
- the active assets test which requires an asset be an active asset at the time of the capital gain event; and
- the controlling individual test.

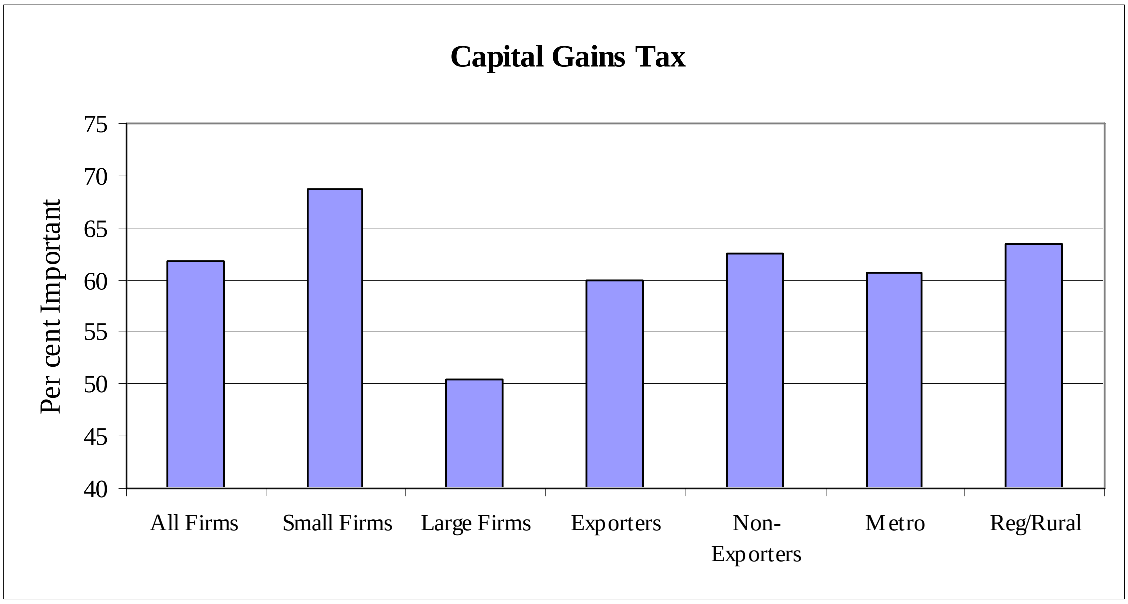
The specific CGT concessions for small business are quite substantial. ACCI is not arguing for further specific concessions for small business. Instead, ACCI argues that the burden of CGT should be reduced more generally.

2.3 Survey of CGT Concerns

ACCI conducts regular surveys of our members. Relevant to the current review is our pre-election survey, conducted in the first half of 2004 (there were 1685 respondents).

Respondents were asked about their level of concern with a range of taxation measures (for example, personal income taxes; fringe benefits tax; company tax; capital gains tax; and, the goods and services tax).

The following chart shows the percentage of respondents who regard capital gains taxes as an important problem for their enterprise (being either a major or moderate concern).



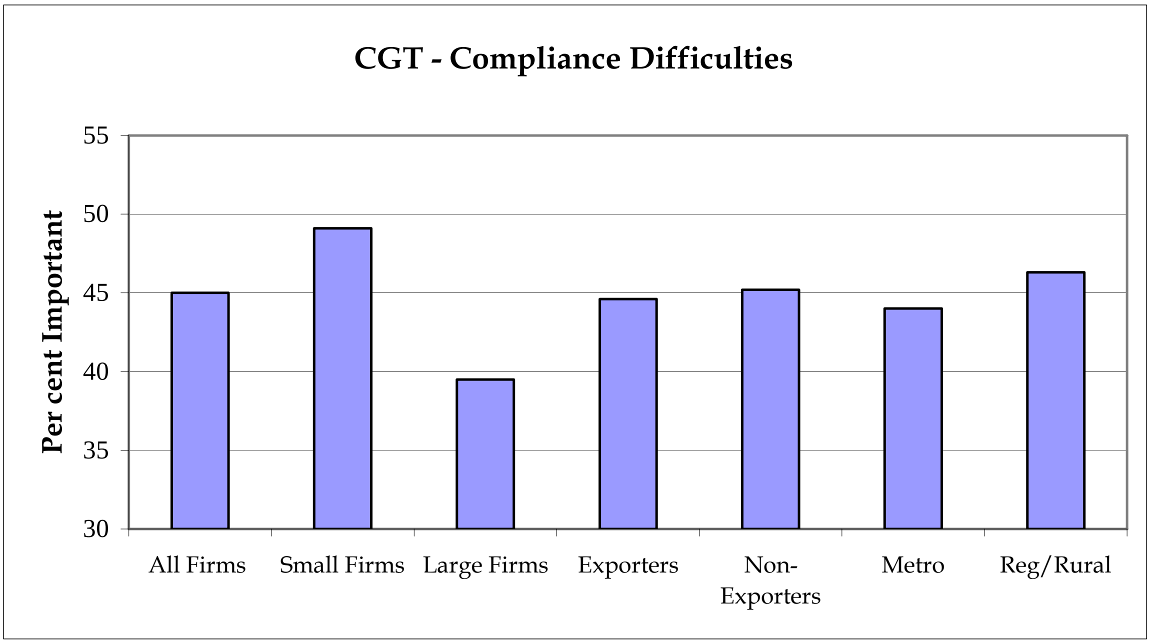
The capital gains tax is an important problem for 62 per cent of all firms polled, although it is substantially more important for small firms (69 per cent) than larger firms (51 per cent).

Non-exporters (63 per cent) are slightly more troubled by the capital gains tax regime than exporters (60 per cent), as are firms in regional/rural areas (64 per cent) compared to those in metropolitan areas (61 per cent).

2.3.1 Compliance Difficulties

The survey also questioned business respondents on any compliance difficulties they may have with a range of taxes, including the capital gains tax.

The following chart shows the percentage of respondents who regard compliance difficulties with the capital gains taxes as an important problem for their enterprise.



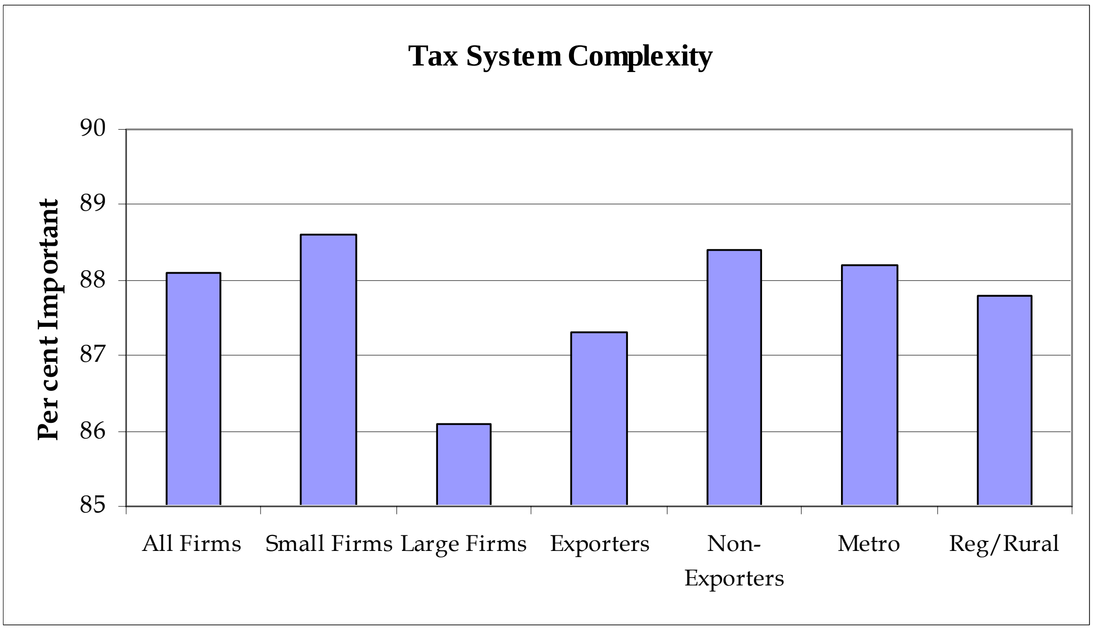
Compliance difficulties associated with the capital gains tax are an important problem for 45 per cent of all firms surveyed, being substantially more important for small firms (49 per cent) than larger firms (40 per cent).

Levels of concern were much the same for exporters and non-exporters (both around 45 per cent), and for firms in regional/rural areas (46 per cent) and in metropolitan areas (44 per cent).

2.3.2 Overall Complexity

The survey also questioned business respondents on their attitudes to the overall complexity of the Australian taxation system.

The following chart shows the percentage of respondents who regard the overall complexity of the taxation system as being an important problem for their business.



The overall complexity of the taxation system is an important problem for almost all Australian firms, regardless of their size, whether they export or no, and whether they are metropolitan or regional/rural based.

A massive 88 per cent of business respondents (All Firms) regard the overall complexity of the tax system as a problem for their firm, with smaller firms (89 per cent) somewhat more concerned than larger firms (86 per cent).

Non-exporters (88 per cent) were slightly more troubled than exporters (87 per cent), with little real difference between metropolitan and regional/rural based firms (both around 88 per cent).

2.4 ACCI Policy

ACCI released its *Taxation Reform Blueprint* in 2004[1]. The blueprint includes a detailed discussion of business concerns with Capital Gains Tax (CGT) and some proposed reforms.

In summary:

- Business received significant benefits from the changes to CGT that occurred in 1999 as part of the Review of Business Taxation (RBT).
- However, since then other countries have increased or extended their concessions for CGT that mean that Australia is less competitive on the taxation of capital gains.
- Business considers that further reform of CGT is very important. Business considers that the current system for taxing capital gains creates barriers to capital formation and job creation; reduces savings and reinvestment; and restricts entrepreneurial activity.
- Business therefore proposes that the Government should seriously consider:

[1] Available from ACCI's website, www.acci.asn.au

- introducing a stepped rate of CGT to significantly reduce the burden of tax on capital gains and encourage increased investment;
- allowing the carry-back of capital losses;
- an extension of rollover provisions; and
- franking credits for capital gains.

Further details on these proposals are available in ACCI's *Taxation Reform Blueprint*.

3 Review of CGT Concessions for Small Business

Small businesses are appreciative of the changes the Government announced in 1999. However, there is some evidence that the takeup of the changes is limited, primarily due to their complexity.

3.1 Improvements in the 1999 changes

The 1999 changes did make tax system simpler in a few ways:

- Previously, there was a 50 percent exemption for goodwill. The definition of goodwill was reportedly subject to some dispute and litigation. The broader exemption for active assets is simpler.
- The previous rollover provisions may have encouraged taxpayers to roll gains into goodwill and then using the goodwill exemption.
- It made it easier to meet the retirement exemption by:
  - removing the requirement for directors to resign; and
  - removing the requirement that a controlling individual is both a director and employee;
- It reduced the distinction between asset sales and share sales for the retirement exemption.

However, there are significant concerns that the reformed provisions are still complex, so that few small businesses have taken them up.

3.2 Concerns with the current rules

ACCI broadly supports the following concerns raised by the Institute of Chartered Accountants[2], CPA Australia[3] and the National Farmers' Federation[4]:

- The target group for the concessions has not been made clear – whether the concessions target 'mum and dad' operations or are meant to be more widely available.
- The concessions do not provide significant assistance to succession planning for small business.

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[2] See http://www.icaa.org.au/upload/download/Submission_CGTconcession.pdf
[3] See: http://www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FEDF-B8A3492/cpa/320157_1.pdf
[4] See:
http://www.nff.org.au/pages/sub/Small%20Business%20Capital%20Gains%20Tax%20Concessions.PDF

- The concessions do not apply to small businesses operating through a number of ownership structures, for example companies owned by discretionary trusts and unit trusts with more than two unit holders.
- The $5 million asset threshold (for the 50 percent exemption and rollover relief) is too low, given the strong increases in property prices since 1999. A number of genuinely small firms would not meet this test.
  - A similar concern could be raised about the $0.5m threshold for the retirement exemption.
  - In addition, the asset threshold is different from other thresholds (such as the STS threshold), creating confusion and complexity.
- The asset threshold may include all of the value of a taxpayer's residence, even if only a small portion is used for to produce income.
- The operation of the asset test for partnerships, the retirement exemption, the controlling individual test and the definition of "connected with" are complex and unclear.
- The requirement that liabilities be related to assets needs clarification.
- There are various problems with the definition of active assets (relating to cash, contingent claims, shares and deceased estates).
- The requirement that assets be active at the time of sale is onerous and too restrictive.
- Rulings on the concessions should be made soon.

3.3 Anti-avoidance

Significant anti-avoidance provisions exist in the CGT concessions, which complicate the exemptions and may make small businesses reluctant to use the provisions.

ACCI accepts that anti-avoidance provisions are needed to stop abuse of tax concessions. However, these provisions can go too far.

Potential anti-avoidance provisions should be discussed at the start of consideration of policy proposals. If a tax proposal requires very complex anti-avoidance rules, then it may be better to redesign the proposal to ensure that these rules are not required.

A tax provision with very complex anti-avoidance rules may be useless if the complexity of the anti-avoidance rules means that almost no taxpayers make use of the provision.

These arguments do not necessarily apply to the CGT concessions for small business, but are relevant to examination of the concessions.

3.4 Conclusion

Small business is supportive of measures to reduce the burden of taxation, particularly through capital gains. However, the current CGT concessions for small business are complex and difficult to use, even for practitioners. Therefore, it is unlikely that the concessions have met their original policy intentions.

4 ACCI membership

4.1 State/Territory Associations

ACT and Region Chamber of Commerce and Industry
Australian Business Ltd
Business SA
Chamber of Commerce and Industry Western Australia
Chamber of Commerce Northern Territory
Commerce Queensland
Employers' First ™
State Chamber of Commerce (New South Wales)
Tasmanian Chamber of Commerce and Industry
Victorian Employers' Chamber of Commerce and Industry

4.2 National Industry Associations

Agribusiness Employers' Federation
The Association of Consulting Engineers Australia
Australian Beverages Council
Australian Consumer and Specialty Products Association
Australian Entertainment Industry Association
Australian Hotels Association
Australian International Airlines Operations Group
Australian Made Campaign Limited
Australian Mines and Metals Association
Australian Paint Manufacturers' Federation
Australian Retailers Association
Housing Industry Association
Insurance Council of Australia
Investment and Financial Services Association
Master Builders Australia
Master Plumbers and Mechanical Services Association Australia
National Electrical and Communications Association
National Retail Association Limited
NSW Farmers Industrial Association
Oil Industry Industrial Association
Pharmacy Guild of Australia
Plastics and Chemicals Industries Association
Printing Industries Association of Australia
Restaurant and Catering Australia
Standards Australia Limited
Victorian Automobile Chamber of Commerce