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2 May 2005

Mr Bruce Paine
Secretary
The Board of Taxation
c/- The Treasury
Langton Crescent
Parkes ACT 2600

Dear Mr Paine

Board of Taxation: Post-Implementation Review of the Small Business Capital Gains Tax (CGT) Concessions

Thank you for your letter inviting The Pharmacy Guild to make a submission to the Board of Taxation in connection with its Post-Implementation Review of the Small Business Capital Gains Tax Concessions in Division 152 of the *Income Tax Assessment Act 1997.*

On behalf of The Pharmacy Guild, I welcome the opportunity of providing some brief comments as attached in regard to quality and effectiveness of the small business CGT concessions which have been introduced to date.

Yours sincerely

Stephen Greenwood
Executive Director

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Submission to the

Board of Taxation's Post-Implementation Review of the Small Business Capital Gains Tax (CGT) Concessions

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1. Background

The Pharmacy Guild of Australia was established in 1928 and registered under the then Conciliation and Arbitration Act (now Workplace Relations Act) as a national employers' organisation. Our members are the pharmacist proprietors of some 4,500 independent community pharmacies, which are small retail businesses spread throughout Australia. Almost 90% of all pharmacist proprietors are Guild members.

Community pharmacy makes a significant contribution to the Australian economy with an annual turnover of $10 billion and $250 million in tax revenue, employing some 15,000 salaried pharmacists and 25,000 pharmacy assistants. The average turnover in pharmacy in 2002-2003 was $2.1 million and based on current projections is expected to reach $2.8 million in 2005-2006.

Many Guild members operate their businesses as sole traders and partnerships because, under the terms of the State and Territory Pharmacy Acts which govern the operation of community pharmacies, incorporation is not permitted, except in the case of South Australia and the two Territories. However, all of the Pharmacy Acts are currently under review and it is likely that amendments will be made in most of the Acts, if not all, to allow greater flexibility of business structures, including the ability to incorporate.

2. Government's Policy Intent

The Guild notes that the current CGT small business concessions were introduced in 1999, as an improvement on the former CGT concessions and are aimed at providing small business people with access to funds for expansion of their businesses, or for retirement.

It is our understanding that the reforms were expected to increase the level of benefits available to small businesses by providing greater flexibility in how these benefits might be accessed and by ensuring that CGT would no longer be an impediment to investment by small business.

This was to be achieved by enabling a small business to be:

- eligible for the general CGT 50% concession;
- eligible for the 50% active assets exemption;
- able to elect to roll the remaining 25% of the gain into replacement assets, or
- able to apply the remaining 25% towards the $500,000 CGT retirement exemption;
- exempt from CGT where active assets are held for 15 years or more;
- able to benefit successively from all of the concessions for any one disposal, thereby reducing any unnecessary compliance costs.

The main features of the concessions are as follows:

- the relevant asset must be an active asset or be a company share, trust unit or other membership interest where the taxpayer is a controlling individual of the entity carrying on the business

- an active asset is an asset used in the business (eg land and buildings) or an intangible asset inherently connected with the business (eg goodwill)

- if the asset is a membership interest, it has to satisfy a 'look through' rule to the company's or trust's assets requiring that 80% or more of the entity's total assets be active assets for at least half of the period the assets were owned

- a limit of $5 million on the net value of the assets that the taxpayer and connected entities can own

- certain additional requirements were specified in respect to the 15-year CGT exemption.

3. Evaluation Criteria

The Guild notes that the Board seeks to measure the effectiveness of the legislative changes giving effect to the small business Capital Gains Tax concessions against the following criteria; that the legislation should:

- seek to reduce, or at least limit, compliance and administration costs;
- be clear and comprehensible for small business;
- avoid unintended consequences of a substantive nature;
- take account of actual taxpayers circumstances and commercial practices;
- be consistent with other tax legislation;
- provide certainty.

4. Guild Comments

The Guild believes that there has been considerable value to small business as a result of the reforms which were introduced in 1999. Discussions with pharmacists' accountants reveal that the goodwill provisions are a great improvement over those previously in place and that small business owners are able to take advantage of the increased flexibility in the retirement options now available.

That said, there is still room for improvement in order for small businesses such as pharmacies to take full advantage of the concessions.

- There is still complexity and consequent uncertainty in the existing provisions.
- Compliance costs are still a major issue with regard to the current provisions.

4.1 Business Structures

- Some pharmacy proprietors are unable to access the various concessions because of the business structures they have established, such as discretionary trusts in those jurisdictions where they have been unable to incorporate their business.

4.2 50 Per Cent Rule

- The easiest way to access the current CGST tax concessions is to hold assets in the individual's name. However, many pharmacy businesses are conducted via trust structures, or in South Australia and the Territories, as companies. The percentage required to be considered a controlling individual is currently 50 per cent, which possibly causes problems for some of our members. The Guild recommends that consideration be given to reducing this threshold to 40 per cent.

- The Guild understands the Government's consideration in setting the 50 per cent rule in order to specifically assist business owners trading in their own name. However, given that a sole trader is likely to pay tax at the highest marginal tax rate of 48.5 per cent and that the company tax rate is only 30 per cent, it is understandable that many small business people seek to incorporate their businesses in order to have their income assessed at this lower tax rate. In the case of pharmacies, in those jurisdictions where incorporation is not allowed, this often results in the setting up of discretionary trusts.

- The reasons for doing this would largely disappear if the highest marginal tax rate was set at the same level as is the company tax rate; ie 30 per cent. The Guild believes that there would be merit in the Tax Board making this recommendation to the Treasurer.

4.3 Maximum Net Asset Value Test

- The net $5 million asset test, while perhaps not a problem for the small to average pharmacy business, is probably not high enough for some of our members. Given the increasing value of pharmacies and property prices in the current economy, this net asset limit should be reviewed regularly and certainly should be indexed on an annual basis.

4.4 Small Business Asset Rollover Concession

- Problems may be encountered for those pharmacy proprietors wishing to take advantage of changes to pharmacy legislation which enable them to transfer their business over to a company structure. (These changes are occurring as a result of the current reviews of the Pharmacy Acts referred to in the Background section of this paper.)

- Given the likelihood that some pharmacies will take advantage of these changes, it is important that the CGT benefits still remain available in those cases. The legislation should ensure that the fifteen year ownership period is not broken where a small business is rolled from a small trader or partnership into a company structure.

4.5 Disincentives for Superannuation

- The Government introduced an excellent reform in allowing small businesses like pharmacies to roll over $500,000 into superannuation, from the sale of their businesses on retirement, without attracting any Capital Gains Tax.

- However, the problem is:

  - the $500,000 is a flat figure, not indexed, yet the value of businesses (including property values) has already significantly increased (well ahead of inflation) since the introduction of this measure and will continue to grow;

  - this $500,000 counts towards the Reasonable Benefits Limit (RBL) - RBL is only $619,223 for a lump sum; $1,238,440 for a pension. Benefits in excess of these limits are taxed at 48.5% (the highest marginal rate);

  - these limits are low and it doesn't take much then for an RBL to be exceeded and for the retiree to be faced with paying this excess tax.

- The Guild believes that in order for the Government to make superannuation more attractive to small business so that a greater number of people could fund their own retirement, the following changes should be implemented:

  - index the $500,000 in line with the growth in the value of businesses
  - make the $500,0000 non-assessable to RBL
  - increase the RBLs to be in line with the true cost of living today.

5. Recommendations

5.1 That the legislation be further reviewed to reduce complexity and consequent uncertainty in the existing provisions and to reduce compliance costs.

5.2 That consideration be given to reducing the percentage threshold for a controlling individual from 50 per cent to 40 per cent.

5.3 That the Board recommend to the Treasurer that the highest marginal tax rate of 48.5 per cent be reduced to 30 per cent to be in line with the current company tax rate.

5.4 That the net asset limit of $5 million be reviewed regularly and indexed on an annual basis.

5.5 That the legislation ensure that the fifteen year ownership period is not broken where a small business is rolled from a small trader or partnership into a company structure.

5.6 That in order to make superannuation more attractive to small business, the Board recommend to the Treasurer that:

- the $500,000 be indexed in line with the growth in the value of businesses;
- the $500,0000 be non-assessable to RBL; and
- the existing RBLs be increased to be in line with the true cost of living today.