



25 November 2008

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*Via email*

Dear Mr McMahon,

**SUBMISSION – INCREASE ACCESS TO THE SMALL BUSINESS CAPITAL GAINS TAX CONCESSIONS VIA THE \$2 MILLION AGGREGATED TURNOVER TEST**

Taxpayers Australia welcomes the opportunity to comment to Treasury in response to the draft legislation *Tax Laws Amendment (2008 Measures No.7) Bill 2008: CGT concessions for small business* which was released for public comment on 14 October 2008.

We appreciate government's initiative in updating the small business capital gains tax concessions in the legislation. In our opinion this draft legislation under review is overly complex and repetitious. Taxpayers Australia does not support the incorporation of these provisions into the law in their current form. We do support the underlying intention as per the Explanatory Memorandum but we recommend the amending provisions be redrafted to improve clarity.

The appended document sets out our views in response to the issues raised.

Should you wish to discuss any aspect of this submission please contact either Ms Heather Schache or Ms Jacqueline Hodges on 1 300 657 572.

Kind regards

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# Taxpayers Australia Inc

## Increase access to the Small Business Capital Gains Tax concessions via the \$2 million Aggregated Turnover Test

### Submission

25 November 2008

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## Background to Taxpayers Australia Inc

Taxpayers Australia Inc (formerly known as Australian Taxpayers Associations) was established in 1919 and is a not-for-profit organisation committed to educating, informing and representing business and individual taxpayers alike.

We are not affiliated with any political party or any pressure group, and regularly make submissions to the government on taxation and superannuation issues on behalf of our members and all Australian taxpayers. We are represented on major consultative forums with the Australian Taxation Office.

Taxpayers Australia Inc is also a founding member of the World Taxpayers Associations and the Asia Pacific Taxpayers Union.

Our aim is to educate and inform taxpayers via our expert publications, online information, media and seminars on tax and superannuation issues and to bring to members the latest and most effective tax information.

Our members include tax providers, accountants, tax agents, financial planners, business people, corporations, investors, students and individual taxpayers with whom we provide up-to-date information in plain English.

## Executive Summary

Our commentary sets out our views on the exposure draft amending legislation based around the following:

- 1 General Comments
- 2 Specific Comments

Taxpayers Australia welcomes the improvements to the small business capital gains tax provisions however we suggest that the proposed legislation lacks clarity being too repetitious and cumbersome. This drafting does not in our opinion meet the objective of simplifying the law.

In our opinion the overall commentary to the exposure draft sufficiently explains the proposed legislation as it stands. However, should the legislation be redrafted this document would need revising.

Taxpayers Australia recommends a redrafting of the exposure draft to improve the grammatical and structural soundness of these provisions.

Should the document be redrafted, we would appreciate a further review and consultation prior to enactment.

## General Comments

In earnest, we appreciate the difficulty government has in drafting new provisions during this time of great legislative change and tax system review. As noted by the Henry review this is a time where government seeks to improve the tax system.

Our considerations on this exposure draft are as follows.

### 1. General Comments

#### 1.1 Main amendments

Overall the intention of the amendments can be elucidated however the complexity in the wording of the main amending provisions makes reading and interpretation of these provisions difficult. Our specific concerns and recommendations are outlined in the following section.

#### 1.2 Other amendments

Overall we find the other amendments necessary and only make one comment in regard to this section.

#### 1.3 Explanatory Memorandum

Overall the Explanatory Memorandum satisfactorily explains the intention of the draft provisions. Our only concern with this version is some of the examples are perhaps too conceptually based.

#### 1.4 Commencement

We note, the government announced it would increase access to the small business Capital Gains Tax (CGT) concessions for taxpayers owning a CGT asset used in a business by a related entity and for partners owning a CGT asset used in the partnership business in the 2008-09 budget.

The proposed commencement date in the exposure draft is the day on which the Act receives the Royal Assent. While, we do not favour the operation of retrospective legislation, we acknowledge that certain taxpayers may have acted in accord with the budgetary announcement.

## Taxpayers Australia Inc

### Small business capital gains tax concessions

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This announcement as noted in Budget Measures Budget Paper No. 2 provided the amendments would be effective from the 2007-08 income year. We request government consider the appropriateness of the commencement dates.

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## Specific Comments

### 2. Part 1 – Main amendments

#### Treatment of passively held CGT assets

##### 2.1 Section 152-46 Use of CGT assets by affiliates or entities connected with you

###### Our concerns

While the wording of in subsection (1) is clearly understood it is overly repetitious. A possible approach would be to combine the repeated paragraphs. This would mean that in practice those applying the law would choose the treatment appropriate to a class of asset.

Subsection 152-46(2) draws in the relationship between Division 152 and Division 328, being the small business entity test as applicable to ‘affiliates’ and ‘connected entities’ that would not otherwise be considered to carry on a business.

While the intention is clarified through the Explanatory Memorandum, the wording of this subsection is convoluted referencing three sections within one sentence. Thus making the physical reading of the law onerous and increasing the difficulty of interpretation.

Subsection 152-46(3) applies to one CGT asset but more than one business. It would appear the intention is to include the turnover of all related entities. This is difficult to determine for this section and little additional wording is expressed in the Explanatory Memorandum.

Little confidence is gained by the reader with the inclusion of the words “to avoid doubt” in subsection 152-46(4).

###### Recommendation:

We suggest that the section could be rewritten, for example, as per the following without loss of meaning.

Due to the lack of clarity in the intention, no suggestion has been made for subsection 152-46(3). We recommend that this subsection be redrafted and a practically-based example be included in the Explanatory Memorandum.

**Section 152-46 Use of CGT assets by affiliates or entities connected with you**

(1) This section applies if you own a CGT asset that is:

- (a) an asset (whether the asset is tangible or intangible) that is used, or held ready for use, in the course of carrying on a \*business in an income year by your \*affiliate or an entity \*connected with you, or
- (b) an intangible asset that is inherently connected with a business that is carried on in an income year by your affiliate or by an entity that is connected with you

and

- (c) all of the following apply:
  - (i) the affiliate or entity connected with you (as the case may be) is a small business entity for the income year;
  - (ii) you do not carry on a business in the income year (other than as a partner in a partnership); and
  - (iii) the asset is not an interest in a partnership.

*Small business entity test*

- (2) For the purposes of this division only, you are taken to carry on the \*business mentioned in paragraphs (1)(a) or (1)(b) provided you meet the small business entity threshold in section 328-110.
- (3) Delete "To avoid doubt"

## **2.2 Section 152-47 Spouses or children taken to be affiliates**

### **Our concerns**

The issue of whether a company or trust controlled by a spouse or child not yet 18 could access the small business concessions was raised through the NTLG Losses and CGT Sub-committee in November 2007.

We appreciate the intention of this section is to extend the application of those taken to be 'affiliates' or 'connected with' the asset holder. Further, the Explanatory Memorandum indicates the intention of this amending section was to include entities owned or controlled by an affiliated spouse or affiliated child not yet 18.

In our view, the wording in this amending section creates confusion in its complexity. Although slightly extended, subsections 152-47(1) & (2) are a rewording of phrases already existing in the law under 152-40(1A).

Albeit, we note the use of the term 'entity' within sections 152-47(1) and (3) yet find it difficult to elucidate the relationship or application of the provisions to a company or trust that is controlled by an individual being an 'affiliate' or 'connected with' the small business entity. In particular section 152-47(2) appears to taper the meaning back to that of affiliates of an individual, being a spouse or a child.

Subsection 152-47(3) provides reference to sections 328-110 and 328-125, being provisions defining a 'small business entity' and 'connected with'. Yet there is no reference to section 328-130 being the meaning of 'affiliate'.

Subsection 152-47(3) includes an example which does little but rephrase the subsection and should be removed. We believe the examples provided in the Explanatory Memorandum sufficiently illustrate the intention.

The terms 'affiliate' and 'connected with' appear to have a broader definition within Division 328. We contend that the small business entity approach should be consistently applied within the legislation. However, should the legislators apply a separate definition for the small business CGT concessions then the link of the terms to those in Division 328 is irrelevant.

We acknowledge clarifying and limiting factors may be required when this section is inserted into the law, section 152-47 should state simply the meaning of an affiliate for the purpose of this division.

Furthermore, it would appear that with the inclusion of the words “to avoid doubt” in subsection 152-47(4) that the legislators are expressing concern within the amending provisions as to the clarity of reasoning of the section. We suggest the section should be expressed so as to clearly state the law without a clarifying subsection.

**Recommendation:**

We suggest that the sections 152-47(1), (2) and (4) be redrafted for example as per the following, with paragraph (4) adopted into the wording of paragraph (2). No suggestion has been provided for section 152-47(3).

**Section 152-47 Spouses or children taken to be affiliates**

- (1) This section applies if you own a CGT asset (whether the asset is tangible or intangible); and
  - (a) the asset is used, or held ready for use, in the course of carrying on a \*business in an income year by another entity; or
  - (b) the asset is inherently connected with a business that is carried on in an income year by another entity.
  
- (2) For the purposes of this Subdivision, in determining whether the entities mentioned in subparagraphs (1)(a) and (1)(b) are an affiliate or are connected with, the following are affiliates of the individual:
  - (a) a spouse of the individual, but only while that spouse remains a spouse;
  - (b) a child of the individual, being a child who is under 18 years.

**2.3 Section 152-48 Use of CGT assets by partnerships**

**Our concerns**

Similarly to section 152-46, discussed earlier, our concerns in reference to this subsection surround the repetition of phrases.

**Recommendation:**

We suggest that the section could be rewritten for example as per the following without loss of meaning.

**Section 152-48 Use of CGT assets by partnerships**

(1) This section applies if you own a CGT asset that is:

- (a) an asset (whether the asset is tangible or intangible) that is used, or held ready for use, in the course of carrying on a \*business by a partnership during a period in an income year, or
- (b) an intangible asset that is inherently connected with a business carried on by a partnership during a period in an income year

and

- (c) all of the following apply:
  - (i) you are a partner in a partnership during the period;
  - (ii) the partnership is a small business entity for the income year;
  - (iii) you do not carry on a business in the income year; and
  - (iv) the asset is not an interest in an asset of the partnership.

*Small business entity test*

- (2) For the purposes of this division only, you are taken to carry on the \*business mentioned in paragraphs (1)(a) or (1)(b) provided you meet the small business entity threshold in section 328-110.

Note 1. This applies to partners in a partnership despite subsection 328-110(6).

- (3) Delete "To avoid doubt"

## **2.4 Section 152-49 Working out your aggregated turnover**

### **Our concerns**

In principal this section is sufficiently clear with only minor issues. Subsection 152-49(2) provides a positive calculation of the aggregated turnover, while subsection 152-49(4)(a) is a negative test for excluding the turnover of certain entities. Subsection 152-49(2) encapsulates the turnovers of the included entities making 152-49(4)(a) redundant.

### **Recommendation:**

We suggest for the purposes of clarity that subsection 152-49(1) be redrafted.

Subsection 152-49(3) appears explanatory rather than legislative. As such, we consider this paragraph be incorporated as a note to section 152-49 and the meaning be extrapolated in the Explanatory Memorandum.

We suggest that subsection 152-49(4)(a) is redundant and should therefore be removed from the amending provisions.

Again the words 'To avoid doubt', has a negative connotation and no legislative application and should be removed.

### **Section 152-49 working out your aggregated turnover**

- (1) This section applies if you are taken to carry on a \*business in the income year under subsections 152-46(2) and 152-48(2):

Note 1. The annual turnover of an entity is included only once even if the entity is both an affiliate and connected with the first entity.

#### *Excluded amounts*

- (4) For the purposes of subsection (2), do not include the amounts derived in the income year by an entity, if:
- (a) The amounts are derived from dealings with another entity whose \* annual turnover is also included under...

*Disapplying subsection 328-115(3)*

- (6) Subsection 328-115(3) does not apply in working out your aggregated turnover under this section.

## **2.5 Subsection 328-110(1)**

### **Our concerns**

There is only a minor consideration in the wording of this section being the use of the words 'small business relief'.

### **Recommendation:**

While the note indicates the relief applies specifically to subsections 152-46 and 152-48 we suggest for the purposes of clarity and consistency 'small business relief' be changed to 'small business CGT concessions'.

## Concluding Comments

We note with concern that although some consideration has been given to the interaction of these provisions with Subdivision 152-E, a disparity continues between practical application of that subdivision and sufficient operating legislation.