



INSTITUTE OF
**PUBLIC
ACCOUNTANTS®**

**Improving the integrity
of the small business
CGT concessions -
Treasury Laws
Amendment (2018
Measures) Bill 2018**

February 2018

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our submission on 'Improving the integrity of the small business CGT concessions'.

The IPA is one of the three professional accounting bodies in Australia, representing more than 35,000 members and students throughout Australia and internationally. The IPA prides itself, in not only representing the interests of accountants, but also small business and their advisors.

We look forward to discussing further and in more detail the IPA's recommendations with the Government and Treasury. Please address all further enquires to Tony Greco +61 3 8665 3100.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tony Greco', with a large, stylized flourish on the left side.

Tony Greco
General Manager Technical Policy

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IPA Submission

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Improving the integrity of the small business CGT concessions Treasury Laws Amendment – Treasury Laws Amendment (2018 Measures No.) Bill 2018

Dear Sir/Madam

The Institute of Public Accountants (IPA) welcomes the opportunity to make a submission on Improving the integrity of the small business CGT concessions. The Institute has members that work with business clients that can be affected by the provisions of the proposed changes to the law.

Small Business CGT Concessions

Small Business CGT concessions, allow small business owners with net assets of no more than \$6m or annual turnover of less than \$2m to disregard or defer some or all of a capital gain from an active asset used in a small business. There are four CGT concessions for small business which can apply for the disposal of business assets:

1. the small business 15-year exemption
2. the small business 50% reduction
3. the small business retirement exemption and
4. the small business roll-over.

However, to qualify for the concessions, a taxpayer must satisfy a number of conditions which can be quite complex. The amendments proposed will add an added degree of complexity to the existing provisions, particularly for gains relating to

shares in a company or interests in a trust. The small business CGT concessions are already perceived by most practitioners as quite complex. We are encouraged that the Board of Tax will look at these concessions as part of its broader review of all small business tax concessions. In relation to the proposed changes contained in the exposure draft and explanatory material, we provide the following comments:

Partnerships interests ignored

It appears this integrity rule has ignored partnerships. Small Business CGT concessions can currently be accessed by partners in very large partnerships. The maximum net asset test is often applied to each partner's fractional interest in the partnership, without regard to the size of the partnership. The proposed amendments relate to shares in a company or interests in a trust and is notably silent when it comes to partnerships.

Policy Intent

As part of its 2017-18 Budget handed down on 9 May 2017, the Government announced proposed amendments to the tax law which would limit the application of the small business CGT concessions (SBCGT Concessions). The Draft Legislation is seeking to prevent the SBCGT Concessions from being used by taxpayers with significant wealth, in a manner which is inconsistent with the underlying policy intention.

The Draft Legislation succeeds in addressing the above integrity issues. However, whilst doing so in the manner proposed, may also arguably exclude many genuine small taxpayers from obtaining the SBCGT Concessions. The Draft Legislation proposes significant amendments that go beyond what most expected from what was announced. In particular, the requirement for the Object Entity to meet the MNAV or small business entity test will exclude taxpayers who are presumably outside the integrity concern which the legislation is targeting.

Making things worse is that the proposed new rules will have retrospective effect and apply to CGT events happening on or after 1 July 2017. Some taxpayers will be

adversely impacted where CGT assets have been sold after 30 June 2017 and the existing SBCGT Concession rules have been applied.

For example, a taxpayer owns 30% of a company with a turnover of \$9m and MNAV of \$9 million. Despite the fact that the interest is only worth \$2.7 million, the taxpayer will be precluded from applying the SBCGT Concessions as the Object Entity (ie the company) doesn't meet the MNAV or small business entity test. This result does not appear to be the mischief the proposed legislation aims to target given the clear policy intent.

The Draft Legislation will provide a significant integrity improvement to the SBCGT Concessions. Specifically, the requirement for an Object Entity to be a CGT small business entity or satisfy the MNAV would make it more difficult for taxpayers to arrange their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the SBCGT Concessions. However the scope of the changes will affect many more scenarios than the policy intent contemplated. Some rationale for policy shift is required to explain the Government's position.

Modified Active Asset Test

The proposed draft legislation seeks to amend the modified active asset test to restrict when cash and financial instruments will be included in the 80% test. The impact of this will be that it will be more difficult for taxpayers to satisfy the active asset test for capital gains relating to shares in a company or interest in a trust.

Object Entity Carrying on Business

The proposed legislation requires that the object entity be carrying on a business just prior to the relevant CGT event. This may exclude the small business CGT concessions applying to a connected entity holding an active asset used in the business. It is quite common for asset protection purposes, to have valuable business related asset segregated in another entity. The business assets segregated would then be leased at a commercial rate back to the entity running the business.

Given that there are no integrity concerns identified regarding accessing the small business CGT concessions in such arrangements, it seems odd that this new condition has been imposed.

In summary, if the intent for the proposed changes was just to apply to abusive arrangements then the scope of what is being proposed appears to capture more transactions than the policy intent aims to target. A simpler method to better target the mischief identified, would be to require that the relevant asset, have a sufficient link to the relevant small business carried on by the taxpayer.

If the proposed legislative changes to the small business CGT concessions proceed as tabled in the exposure draft, then given the extended scope of the changes made to the rules which has moved the goal posts, the start date should be applied prospectively from the date of Royal Assent instead of from 1 July, 2017.

We look forward to discussing further and in more detail, the IPA's recommendations with the Government and Treasury. If you have any queries or wish to discuss our submission in greater detail then please do not hesitate to contact Tony Greco: (tony.greco@publicaccountants.org.au or telephone +613 8665 3134).

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'Tony Greco', with a stylized flourish above the name.

Tony Greco

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