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Attention: taxboard@treasury.gov.au

BOARD OF TAXATION REVIEW OF SMALL BUSINESS TAX CONCESSIONS

Dear Sir/Madam,

BDO welcomes the opportunity to provide feedback in response to the 2018 public consultation by the Board of Taxation review of small business tax concessions, publically announced on 21 May 2018.

Our recommendations are outlined the Appendix to the submission.

BDO tax practice members were also able to attend the Board of Taxation public consultation sessions in Sydney on 18 July 2018 and Melbourne on 19 July 2018.

Should you wish to discuss any of our comments, please feel free to contact me on +61 2 9240 9736, or via email: Lance.Cunningham@bdo.com.au.

Kind regards,

Lance Cunningham
BDO National Tax Director

Appendix

Core questions

1. What tax issues are of particular concern for small businesses?

The small business tax issues of most concern are summarised below:

- The complexity of some of the small business tax provisions require expensive professional advice that many small businesses cannot afford.
- Bright line thresholds for eligibility to many of the small business concessions results in a huge disparity in treatment for taxpayers just over the thresholds compared to those under the thresholds, this is of particular concern for the small business CGT concessions.
- The purpose behind some of the small business tax concessions is not made clear in the legislation, which can make it difficult to determine whether particular situations fit into the policy intent of the provisions.
- The Board of Taxation's small business tax concessions review should consider what the purpose of the small business tax concessions are and whether they are currently meeting those purposes.
- The main reason for much of the complexity of the small business tax concessions is that they are modifications made to a tax system that has overtime become increasingly convoluted due to dealing with the complex arrangements of a few larger taxpayers.
- BDO suggests that the Government establish a “small to medium business company” that has the asset protection attributes of a company and the distribution flexibility a trust. The small business tax concessions could then be limited to such a small to medium business entity.
- The lower company tax rate for small to medium businesses does not provide much of a benefit for many Australian resident shareholders, as any benefit of the lower company tax rate is reversed when the company pays dividends to the shareholders and they have to pay top-up tax on the dividends.
- The lower company tax rate for smaller businesses has resulted in many companies having trapped franking credits where they have previously paid company tax at the higher rates but when paying out dividends they can only frank at lower tax rates.

These and other issues are expanded below.

The administrative burden that some of the small business tax concessions create for small businesses and their advisers is the most pressing issue. The current small business tax concessions attempt to simplify the tax affairs of small businesses but in some cases do the opposite and make them more complex with difficult to understand qualifying conditions and bright line threshold tests that result in dramatically different outcomes for various taxpayers in similar situations.

The classic examples of this are the \$6 million assets test and \$2 million turnover test for the small business CGT concessions. Taxpayers falling just under these thresholds are paying dramatically less tax than those that are just over the thresholds.

The small business CGT concessions in Division 152 Income Tax Assessment Act 1997 (ITAA 1997) are some of the most complex provisions in all the Australian income tax legislation. We understand the rationale of these concessions is to assist small businesses reinvest in their businesses to help them provide for their retirement in substitution for superannuation fund contributions. However, most small business and many of their tax advisers find it difficult to comply with the complex requirements of these provisions. The provisions are so complex that it is difficult for a small business to confirm that they qualify for a concession under the rules. There are many taxpayers who cannot afford the professional assistance required to correctly calculate their entitlement to the small business CGT concessions because the issues concerned are too complex for them and their regular tax agents to understand. In many of these cases the taxpayers are either not obtaining the concessions they are entitled to or claiming concessions they are not entitled to because this lack of understanding of the complex provisions.

The small business tax concessions have also been introduced gradually over time in an attempt to simplify the system for small businesses, however for some of the concessions the purposes of the concessions are not entirely clear in the legislation. Some of them were introduced to deal with particular issues at the time but there has not been a review of many of them since introduction. We see the Board of Taxation's current review as a good opportunity to consider the purposes of each of the small business concessions and determine whether they are still achieving the purpose the purposes for which they were introduced.

The main reason for much of the complexity of the small business tax concessions is that they are modifications made to a tax system that has overtime become increasingly convoluted to deal with the complex arrangements of a few larger taxpayers. BDO suggests that it would be preferable to establish a new simple tax regime for small to medium taxpayers (refer to question 13 of more detail). This could be done by the creation of a small to medium business entity that has some of the attributes of a company and some attributes of a trust. Such an entity could be designed to provide taxpayers with the ability to obtain both flexibility and asset protection, which is the aim of much of the complex structuring that is currently undertaken by small to medium businesses. The availability of the small business tax concessions could then be limited to the use of such a small to medium business entity.

Another particular concern is the complexities that have been introduced as a result of the lower company tax rate for small businesses. Any benefit from the lower small business tax rate is overtaken by top up tax upon payment of dividends and only beneficial if the small business reinvests their savings and even then there is only a marginal benefit. Many small businesses do not have the need or desire to reinvest in assets as they need the profits to be distributed for the owners living expenses. In addition, the introduction of the lower tax rate has resulted in many companies having trapped franking credits where they have previously paid company tax at the higher rates but when paying out dividends they can only frank them at the lower tax rates. This is causing a lot of problems and resulting in complex structuring to find ways of getting the trapped franking credits out of the companies. The disadvantages from the issue of trapped franking credits outweigh the benefits derived from the tax rate cut. Treasury should re-examine the cost of implementing this measure. It would have been preferable to have provided the company tax cut to all companies.

2. What do you regard as the most useful or effective small business tax concessions? Why?

Small Business CGT concessions

The small business CGT concessions are one of the most useful small business concessions as they allow small businesses to reinvest in their businesses as an alternative to superannuation contributions. This also allows the small businesses to employ more staff and have an increased positive effect on the economy. However, the rules are very complex and can result in inconsistent treatment between taxpayer in similar positions. There are also some distinct differences between the small business CGT concessions and the concessions available through superannuation funds. If the CGT small business concessions are to be seen as an alternative to making superannuation contributions perhaps any review of the concessions should also include a comparison between these concessions and those available under the superannuation system.

Instant asset write off

The \$1,000 instant asset write-off concession is a useful concession that allows small businesses to write off purchases of tools and other lower valued items of plant. The temporary increase of the write-off threshold to \$20,000 was an appropriate mechanism to assist small businesses through the difficult economic time that resulted from the transition from the resources boom to a more business as usual economy. Whether the threshold should remain at \$20,000 should be something the Government needs to consider based on its view of the economic conditions. However, when \$20,000 threshold expires, there is a case to be made for the threshold to be higher than \$1,000 if only to account for inflation. BDO suggested that this threshold be lifted to \$2,000 with either a CPI adjustment or some other mechanism that allows for a review of the threshold every 5 years.

Professional expenses immediate deduction

The immediate deduction for professional expenses concession and small business carve-out for debt and equity rules concession are also useful and could be further extended.

Restructure rollover

The small business restructure rollover introduced in 2016 was an effective change. This concession allows small business entities to transfer active assets to or from other small business entities as part of a genuine restructure of an ongoing business, provided it does not change the ultimate economic owners of the assets.

Refundable R&D offset

The refundable R&D tax concession is very important for growing and innovative companies but it is managed by both the Department of Industry, Innovation and Science and the ATO. BDO suggests that it may be more efficient to have this concession managed by one Federal Government agency.

GST Cash Basis

The ability to account for GST on a cash basis is a valuable small business tax concession. Start-up businesses can often experience cash flow problems. New businesses typically spend significant amounts acquiring assets, such as furniture and fittings, computer equipment, attending to the fit-out of their premises, as well as incurring considerable expenses, such as rent, stationery and the purchase of trading stock (particularly for retail-based businesses). If these outlays are paid by registered businesses, the registered entity is able to claim back the input tax credits associated with these outlays. The main benefit of using a cash attribution basis for GST purposes is that it effectively delays remittance of the GST by the registered business to the ATO until the customer pays the business, thereby improving the businesses' cash flow.

3. What opportunities do you see for improving existing small business concessions?

Small business tax concessions generally

Introduction of a single standard test for small business tax concessions

The small business tax concessions are complex and creating an administrative burden without much benefit so BDO recommend simplification so that there is (once again) a single standard test for small business tax concessions and ideally, the test should at least be the same for Division 152 ITAA 1997 and 328-G ITAA 1997.

An alternative test for high turnover/low margin businesses

A difficult issue is the way that high turnover/low margin businesses are prejudiced in relation to the aggregate turnover test for the small business. That is particularly the case where there are significant, direct inputs involved, such as trading stock. Turnover for businesses that buy goods for sale or to be used in a manufacturing process economically includes a substantial amount to recoup the cost of that trading stock, whereas turnover for a business in a services industry does not include that element. BDO recommends that the Board of Taxation considers an alternative test for high turnover/low margin businesses e.g. by basing calculations on gross profit for businesses with trading stock, rather than turnover. It is accepted that this would add to the complexity of the concession but it may result in enhanced equity.

Small business CGT concessions

Address the Cost of compliance

The small business CGT concessions are complex and impose significant compliance costs on business. It is widely accepted that small businesses, lacking the economies of scale and in-house expertise of their larger counterparts, are disproportionately affected by the cost of compliance. Any change that reduce the complexity of these provisions should be considered.

Index the thresholds for the small business CGT concessions

The thresholds for the small business concessions should be indexed to account for inflation.

Standardised thresholds for the small business CGT concessions

All of the thresholds that small businesses need to navigate should be revisited in order to provide a consistent approach. Under the small business CGT provisions, taxpayers are required to satisfy either the \$6 million asset value test or the \$2 million aggregated turnover test in order to qualify for these concessions. In contrast the small business concessions in Division 328 ITAA 1997 has an aggregate turnover threshold of \$10 million and there is a \$20 million aggregated turnover test applies for the R&D refundable tax offset rules. We note that the proposed reduction to the corporate tax rate for corporate entities that base rate entities have thresholds of aggregated turnover of less than \$25 million for the 2017-18 income year and less than \$50 million for the 2018-19 income year.

The existence of all these different thresholds can often lead to confusion and adds to the complexity of the rules applicable to the small business sector. The above comparison shows that \$2 million turnover and \$6 million asset thresholds for the small business CGT concessions are much lower than the other tests for small business and consideration should be given to

increasing these thresholds. There was a move to standardised thresholds for small business CGT concessions a few years ago, but recent changes to the small business concessions have departed from this standardisation. BDO recommend revisiting standardised thresholds for small business CGT concessions.

Identification of the purpose of the small business CGT small business concessions

The rules around the CGT small business concessions have developed from reasonably simple rules for concessions for disposal of goodwill of a small business that was seen as an alternative to the superannuation concessions where small business owners preferred to reinvest in their businesses instead of investing in superannuation for their retirement savings. However, overtime the CGT small business concession have become more complex and it is not now clear whether the purpose of the provisions is still as an alternative to superannuation fund contributions. There is no indication in the guide to Division 152 at section 152-1 (ITAA 1997) as to what the purposes of the Division are.

BDO recommends that the Board of Taxation reconsiders what the purpose of the CGT small business concessions are and to review the concessions to identify whether the provisions meet these purposes.

Shading of reliefs between the existing cap and a higher cap, so that the small business CGT concessions is not all or nothing

BDO recommend the current eligibility criteria for small business CGT concessions including the 'bright line thresholds' of \$6 million assets test and \$2 million turnover test are too rigid and can incentives taxpayers to derive smaller gains in order to fit under the thresholds. There should be a shading of reliefs between the existing cap and a higher cap, so that the small business CGT concessions is not all or nothing. This can result in perverse outcomes where it is better for a taxpayer to accept a lower price for their business and gain access to the small business concessions, rather than negotiate harder to get what they believe is the true value (but which would put them above the \$6 million threshold). The fact that such small differences in asset value or turnover can cause such large differences in tax outcomes is not a good policy outcome. It also makes the concession more of a 'battlefield' (and cause of personal stress for small business owners) than it needs to be.

Clarified eligibility criteria to access the CGT small business retirement concession small business 15-year exemption

The small business CGT concessions are too complex and in some cases contradictory. For example, the CGT small business retirement concession does not require the taxpayer to retire but under the small business 15-year exemption you do need to retire to get the concession. The names of these concessions can be confusing.

Amendments to simplify the "connected with" and "affiliate" tests

The "connected with" and "affiliate" tests are too complicated. The definition of 'affiliate' in section 328-130 ITAA 1997 is confusing and very limited. Firstly, the definition only applies to individuals and companies but not trusts. Secondly it requires the individual or company to act in accordance with 'your' directions or wishes or in concert with 'you' in relation to the business of the individual or company. This means the affiliate must carry on business. It is not clear why there are these restrictions on the definition of 'affiliate' and many small business taxpayers and some of their advisers find it difficult to understand.

Here is an example that highlights some of the complexities of the ‘connected with’ and ‘affiliate’ definitions, where a partnership of two partners also holds units in a unit trust that owns the partnership’s business premises, the addition of a further partner to the partnership (and ownership of the unit trust will result in the business premises owned by the unit trust ceasing to be an active asset. Pursuant to section 152-40(1)(a)(i) and (ii) ITAA 1997 for an asset which is owned by an entity that does not itself carry on a business to be an active asset, it must either be used or held ready for use in a business carried on:

- by an affiliate of the owner; or
- by another entity which is connected with the owner.

Since the amendments made in 2009 to the definition of affiliate, a partnership cannot be an affiliate of another entity. Therefore, to qualify for the small business concessions, the unit trust must be connected with the partnership. The connected entity test requires 40% control. Prior to the addition of the third partner the partners each had 50% control of both the partnership and the unit trust and therefore the unit trust was connected to the partnership but after the addition of a third partner they are no longer connected entities.

BDO therefore recommend the "connected with" and "affiliate" tests be simplified.

Complexities of using assets such as land for multiple purposes being addressed

There are complexities associated with trying to satisfy the definition of ‘active asset’ under the small business CGT concessions where an asset such as land or a building is used partially for business purposes. There are further complications where the asset is partially used to derive rent.

The definition of ‘active asset’ in section 152-40(1) ITAA 1997 requires the assets to be ‘used or held ready for use in the course of running a business’. There is no indication of the extent to which the asset has to be used in carrying on the business. On a literal reading it appears that there just needs to be some use of the asset in carrying on the business, however, in the recent Administrative Appeals Tribunal of Australia decision, *Rus v FCT [2018] AATA 1854* (22 June 2018), the issue was whether the active asset test is available on the sale of land where only a small portion of that land has been used in a taxpayer’s business. This case involved the sale of a block of land which was mostly vacant, except for 2 houses and a shed occupying about 10% of the land. The shed and an office in one of the houses were used in a construction business operated by the taxpayer through a company. Most of the business activities of the company were conducted off-site. The Tribunal decided that despite there being some use of the land in carrying on the business it was not an active asset. Unfortunately, the Tribunal did not give any guidance on to what extent does the asset have to be used in the business. On the basis that the tribunal decided that use in the business of something less than 10% is not sufficient, where is the cut-off point? Is it 20%, 50% or 100%?

This case highlights the complexity of the law and the extent that clarification is needed to obtain certainty that an asset will qualify as an active asset.

In relation to an asset that is partially used to derive rent, s152-40(4)(e) ITAA 1997 provides that an asset won’t satisfy the active asset test where its main use in the course of carrying on the business is to derive rent (unless the main use was temporary).

Where the asset is used partly for business and partly to derive rent, it will be a question of fact dependent on all the circumstances of the case as to whether the main use of the premises is to derive rent. The ATO view is that no one single factor will be determinative and so it requires a consideration of a range of factors including determining:

- the comparative area of use if the premises between the business and rent
- the comparative times of use of the premises between the business and rent; and
- the comparative levels of income derived from the business and from rent.

Based on the outcome of this complex and time consuming calculation requiring detailed information to be obtained in relation to the use of the asset, a determination is required to be made as to whether or not the main use of the asset is to derive rent. Requiring such a complex calculation to be performed to determine whether an asset is an active asset defeats the purpose of the small business CGT concessions being simple and straightforward. It also can involve medium to high compliance costs to determine the answer to the question, which many small business taxpayers are not prepared to incur.

4. Which current small business concessions are not working and/or should be removed? Why?

The simplified trading stock concession is not a particularly relevant small businesses tax concession because it does not achieve the stated objective of alleviating the requirement for small business taxpayer to conduct an annual stocktake. Firstly, an annual stocktake is seen as a vital internal control mechanism that assists taxpayers in determining exactly how much stock they had on hand at the end of each income year. Irrespective of the trading stock concessions, small business taxpayers would find it beneficial to still carry out a stocktake to monitor inventory losses due to theft, obsolescence and damage. A concession allowing a business not to conduct a stocktake violates the tax principle of efficiency. While efficiency is generally focused on avoiding distortions to economic activities, it stands to reason that a law should not promote operational decisions that are detrimental to the successful operation of a business, which in essence is what this particular concession is doing. Secondly, in order to take advantage of the concession, small businesses are currently required to make a ‘reasonable estimate’ of their closing stock in order to determine whether the value of their closing stock is within \$5,000 of opening stock. In effect, this requirement makes closing stocktake mandatory and the trading stock concession irrelevant.

The unincorporated small business tax discount concession is not a well-known or utilised concession. It is also not encouraging small business owners to reinvest in their small businesses and the \$1000 concession could well be used for other purposes.

5. What ideas do you have for new concessions that could help small businesses?

Pursuant to Subdivision H, comprising s 82KZL to s 82KZO of the Income Tax Assessment Act 1936 (ITAA 1936), inserted by No 95 of 1988 which contains the provisions on expenditure by small business entities and individuals incurring non-business expenditure, small business taxpayers are entitled to an immediate tax deduction in respect of prepaid expenditure provided the eligible service period is less than 12 months, and the eligible service period ends before the end of the income year following the year of expenditure. The prepayment deduction concession is only advantageous however, if the small business has available surplus funds at year-end to make the prepayment (e.g. rent) and it makes commercial sense to do so. Prior to 21 September 1999, there was an original 13-month rule that allowed expenditure incurred on deductible goods or services that were wholly applied within 13 months to be deducted in the year of expenditure. Changes arising from recommendations in ‘A Tax System Redesigned’ sought to limit, for certain taxpayers and arrangements, the tax advantages associated with immediate deductibility by requiring the deduction to be spread over the period when goods or services were provided.

BDO acknowledge that this is a generous concession, but also note the limited ability to prepay many expenses and therefore recommend reinstating the 13-month rule that was repealed in 1999, thereby assisting with tax minimisation as well as assisting with the businesses cash flow and believe this modification would enhance the prepayment deduction concession.

Detailed discussion questions

- 6. Do you agree with the reform principles outlined in this document? Are there any other principles that should be considered? Why?**

BDO believe the current six reform principles are appropriate and provide comments on each one below:

- 1. Concessions should be designed having regard to the small business life cycle**
The highest value small business concessions are provided towards the end of the small business life cycle and while these concessions are important, there needs to be a more of a balance to ensure the benefits being provided at all levels of the life cycle are appropriate. However, care needs to be taken that the concessions do not prop up uneconomic business that are likely to fail anyway.
- 2. Concessions can assist with small business cash flow**
Cash flow is one of the greatest challenges for many small businesses, particularly those in the start-up phase.
- 3. Concessions should relieve the compliance burden for small businesses**
The compliance burden for small businesses is one of the main reasons that many small business owners decide to cease small business or decide not to start a small business in the first place.
- 4. Concessions should promote growth and innovation**
This is probably one of the most important principles.
- 5. Concessions should be targeted and affordable**
This principle is also very important. Some of the existing concessions are not very well targeted and the policy purposes behind some of them are not clear.
- 6. Concessions should not incentivise complex structuring**
This is another important principle and we would extend this to include the principle that the concessions, where possible, encourage simple structuring and in this regard we refer to our suggestion to introduce the concept of a small to medium company that has some attributes of a company and some attributes of a trust but without the complexities if having to deal with the trust law.

BDO recommend a potential seventh principle on identifying the purpose of each of the small business CGT concessions and outlining the exact reasons why they exist and then redeveloping the small business tax concessions in accordance with these newly articulated purposes.

BDO note that not every small business tax concession needs to satisfy every principle.

7. Should certain principles be prioritised over others? Why?

As mentioned above we see principles 4, 5 and 6 as the most important of these principles.

8. What are the objectives of small businesses using a particular legal structure (companies, trusts, partnership, sole trader)?

- a) What are the main objectives businesses have when they seek structuring advice (for example, reducing tax liabilities, succession planning, asset protection, etc.)?
- b) Relative to other factors, how important is reducing tax liabilities
- a) A small business can structure as one of the following:
 - Sole trader (individual)
 - Company
 - Trust (discretionary or fixed)
 - Partnership (any combination of the above as partners)

The objectives of using a particular legal structure as a small business is to have a structure that:

- Maximises asset protection
 - Minimises personal liability
 - Minimises tax liability through the Capital Gains Tax discount
 - Provides access to certain suppliers (for example Bunnings only accepts companies for business purchases)
 - Ensures ease of buying in and out of business
 - Reduces tax liability, which is at the centre of setting up a small businesses legal structure. This is due to the effect tax has on a business's cash flow, bottom-line and future plans.
- b) Each business structure is treated differently under the tax law, both in terms of the applicable tax rate and in terms of the concessions that apply. The choice of business structure may be driven by various objectives of the business, including, asset protection, regulatory requirements, requirements of suppliers or customers, flexibility of distributions etc. However, it is likely in many instances that the tax treatment of different structures is a key factor in choosing a businesses' legal structure. For some small businesses, the cost of identifying the optimal structure (from a tax perspective) may be higher than the benefits they would obtain, particularly given that expert tax advisors are likely to be required to advise and assist with establishing complex structures. The complexity of the tax system can drive owners to seek advice, adding to costs. Further, the potential need for complex business structures can act as a disincentive for some small businesses to pursue growth activities.

As a business grows, it would be increasingly rational for it to adopt the legal structure that would minimise its tax liability. This may involve incorporating, or utilising a trust, but more likely it would involve a combination of structures. The primary objective of these structures is often to minimise tax liability by dispersing income to attract either the lowest marginal tax rate or the corporate tax rate. BDO acknowledge that the objective of many small business structures is to allow both business income and capital gains relating to the business to be taxed at the lowest rate allowable under Australia's income tax laws.

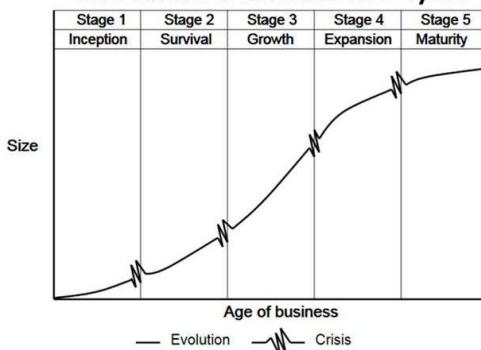
Ultimately Australian small businesses should look to operate as effectively as possible for tax purposes but relative to other factors reduction tax liabilities is equally important as other considerations but no more and no less. Small businesses should be ultimately be driven by aspirational drivers and commercial outcomes, which may include the tax outcomes however, where the tax advantages are the main driver of the choice of structures, it can lead to inefficiencies and complexity for the business and their owners.

BDO considers that the desire to structure a business to legally minimise the tax liability of the business and its owners should be recognised as an appropriate reason for choosing a particular structure and they should not be criticised by Government or others in society for choosing legally allowable structures that minimise tax. However, many of these structures are complex and counterproductive to an efficient economy. Therefore, we suggest it is up to the Government to provide a regulatory environment that encourages the use of more simple, efficient and effective structures for small businesses.

9. Are small business tax concessions skewed to specific parts of the small business lifecycle? If so, should they be refocused and in what way?

Small business tax concessions are currently skewed towards the latter stages of the small business lifecycle instead of during the critical inception and survival stages at the beginning and small business tax concessions geared towards start-ups need to be refined.

The small business life cycle



Small businesses are entitled to certain deductions when starting up a small business for start-up costs including professional, legal and accounting advice and government fees and charges. However most other capital expenditure incurred on costs incurred towards expansion of an existing business are not deductible. BDO suggests that consideration be given to allowing more immediate deductions of certain capital expenditure at the inception stage of a business and also at other times of crisis through the business cycle.

In 2015 the Government introduced start-up tax incentives aimed to help start-ups attract talent by offering employees a tax efficient ownership interest in the business in addition to a salary that may be less than the market rate. The exclusions for the start-up concession however include exclude companies with a turnover of more than \$50m and listed companies which is the majority of technology companies. The concession is also based on aggregated turnover is also prejudicial to some business models like marketplaces, financial services, payments systems and e-commerce retailers of third party products where the turnover is very large but the margins are wafer thin. An online payments business with \$50 million in turnover

might have only \$500,000 in revenue because it operates on a 1% margin. A marketplace with 10% commission might still only generate \$5 million in revenue.

10. Generally, tax concessions are broadly based and apply across different sectors of the economy. Should there be small business tax concessions for specific sectors? If so, why?

Agribusinesses often find it difficult to attract talent to work in regional Australia and they often have to compete with the mining industry to provide competitive salaries making it more difficult to attract the right people prepared to relocate to work in agribusiness in regional and remote locations.

Some small business tax concessions that could be provided to increase the attractiveness of working in the agribusiness industry including:

- Exempting individuals who work in an agribusiness (that is a small business) in a regional area from the luxury car tax as the cost of travel is a major deterrent for people living and working in remote locations and who often require a more substantial vehicle that can handle the rigours of long distance travel.
- Providing individuals who work in an agribusiness (that is a small business) with a tax rebate for working in remote areas in agribusiness.
- Providing agribusinesses (that are small businesses) with Government incentives to take on and train cadets.

11. Does the small business eligibility criteria (for example, the \$2m turnover threshold for small business CGT concessions) influence you to not want to grow your business? Are there alternative mechanisms to phase-out small business tax concessions as opposed to a hard cut-off?

The small business eligibility criteria (for example, the \$6 million asset threshold and \$2 million aggregate turnover threshold for small business CGT concessions) could in some cases influence a small business not to grow. The concessions can have a dramatic effect on the tax outcome for a business at the margin of the particular threshold and it may have an effect on these businesses not expanding if they are looking to utilise the small business concessions in the near future e.g. where the business owners are considering the disposal of the business assets and may be entitled to the small business CGT concessions. To counter this the benefits of the concession should have some sort of phasing-out mechanism so that the benefit reduces incrementally over the phase-out thresholds.

However, where a business owners are not contemplating the short term disposal of the business and looking to grow the business i.e. still in one of the earlier stages of the life cycle, the small business thresholds will generally not influence them to not want to grow their business.

12. What changes to the tax system would make it simpler and reduce the compliance burden for small business?

Small businesses should be given a ‘safe harbour’ in respect of the application of s45B ITAA 1936 where they undertake a demerger under Division 125 ITAA 1997. Where s45B applies in respect of a demerger, it, in conjunction with s45BA, operates to deny the recipient of a demerger dividend the concessional treatment accorded such amounts where they are received as part of a demerger under Division 125 ITAA 1997. It has been our experience that the ATO will rarely, if ever give a ruling that s45B will not be triggered where a small business conducts a demerger under Division 125 ITAA 1997. Demergers result in no economic change to the underlying ownership of assets. As such, concessions are available to make structures more

efficient and allow for the splitting of incompatible business operations from one another. Existing general anti-avoidance provisions are sufficient to deal with the tax mischief of demergers undertaken for other reasons. Accordingly, there is an argument that more definite criteria should be specified for the application of s45B to demergers, at least where they are undertaken by small businesses. A ‘bright line’ test, similar to the three year holding rule under the small business restructure rollover, should be introduced.

As an alternative to the small the medium company as mentioned above, small companies could be allowed the right to choose to be taxed as a partnership. Many small companies are set up only to provide asset protection for the business operators and generally most or all or most profits are distributed to the company shareholders each year. If companies could elect to be treated as a partnership for tax purposes it would cut out a lot of complex tax integrity rules associated with companies and their shareholders. There would be a material saving in compliance costs for many small companies and their shareholders if they could elect into being taxed on a transparent basis in a manner similar to partnerships. A model for such an approach is provided by the tax treatment of ‘S-corporations’ in the United States.

13. Should the definition of small business for tax purposes be changed? If so, how?

It would be easier to have one definition of small business across all legislation with one threshold to ensure consistency. That threshold should also be higher than the CGT small business concessions. Small business tax concessions phased out after exceeding threshold so there is not an all or nothing test.

A new concept of a ‘small or medium business entity’ with some attributes of a trust i.e. flow through and access to small business tax concessions but not subject to trust law should be introduced. An entity flow-through treatment for gains and losses would bestow many of the benefits currently available via the use of a trust with relatively little compliance costs. Such a structure would do away with the complexities of the interaction between tax law and trust law. It may also counter some of the ATO’s current integrity concerns with the use of trusts.

This would eliminate UPE issues and provide them with a safe harbour so they can focus on growing their businesses rather than complying with technical tax legislation. BDO propose that a of the government introduces a new type of company called ‘small or medium business entity’ and the safe harbour treatment in relation to a number of the more complex tax provisions that were introduced to deal with the complex affairs of larger taxpayers are provided for in the tax provisions that deal with small to medium businesses instead of scattered through the tax law. These safe harbour provisions include, thin capitalisation, application of the CFC rules, application of the transfer pricing rules, application of the debt/equity rules (the turnover threshold for ‘debt treatment’ of interest free shareholder loans and application of various FBT exemptions. The nature of the safe harbours should also be the subject of consultation but should be designed to be easy to apply, ‘bright line’ tests to give taxpayers the required certainty.

The required definitions could be incorporated into the existing Division 328 ITAA 1997 and would therefore require aggregation of turnovers of connected entities and affiliates which would act as an integrity measure. We propose that the turnover threshold initially be set at \$20 million per year to align with the R&D refundable tax offset limit, but that this should be subject to 3 yearly reviews, in line with the recently enacted legislation regarding the review of the quantum of a penalty unit under the Crimes Act.

Australia should also examine other jurisdictions. South African law used to provide for a business entity type called Close Corporations until 2011 which has characteristics of both partnerships and companies, is a separate legal entity that exists separately from its members

and profit taxed as company tax and not in the hands of the member. While a new type of vehicle has the potential to create further complexity, if it is well designed and is taken on by the majority of small businesses, after the initial education period, the efficiencies of its operation should offset any complexity of a new type of structure..

The income tax provisions that govern the small to medium business entity should cover all the small business income tax concessions including the small business CGT concessions that is currently in Division 152 ITAA 1997.

14. Does technology make it easier to comply with your tax obligations and access small business concessions? Why or why not?

Software has assisted small businesses with complying with their tax obligations through the automation of activities and tabulation using software such as Xero and MYOB and reduce reliance on expensive accounting advice. There is no evidence however, that use of software and technology is assisting small businesses with accessing small business tax concessions due to the requisite knowledge of the tax legislation that is required to determine eligibility. Therefore, small businesses will still need to use professional advice to understand and utilise small business tax concessions.

Concessions which are intended to provide a benefit to small business introduce other difficulties, such as to cash flow. Small business tax concessions such as those to reduce the regularity of GST payments and pay as you go withholding instalments to once per year, are intended to reduce the amount of paperwork that a small business must comply with and improve small business cash flow in the short term. However, they may cause difficulties where a business owner does not anticipate the size of the payment and does not have the cash flow to pay when it eventually falls due. This could be alleviated with technology development to improve tax liability and payment predictability in which case technology would in fact make it easier for small businesses to comply with tax obligations and access small business concessions.