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Board of Taxation  
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Dear Bruce,

**Re: Post-Implementation Review of the Small Business Capital Gains Tax Concessions**

The National Institute of Accountants (NIA) would like to thank the Board of Taxation for this opportunity to comment on the Small Business Capital Gains Tax (CGT) Concessions. We note that the Board has asked us to respond, even though we may be satisfied with the operation of this tax reform measure. On this issue, the NIA has a number of issues that we wish to bring to the Post-Implementation Review.

In relation to the small business CGT concession, there were a number of issues that caused confusion and misunderstanding amongst taxpayers. Some of those issues still exist, such as what is the definition of a “small business” for the purpose of the concession (as the definition of a “small business” varies within the various income tax and other tax acts). This leads to a lack of awareness amongst some small businesses as to what qualifies for the concession and what does not. There is therefore a need for the ATO to continue to take an educative approach to compliment its enforcement approach on the issue.

Having said the above, the NIA supported the original policy intent of the small business CGT concession as we saw it as an important contribution to the promotion of entrepreneurship. The policy intent does this by encouraging small businesses to build the capital value of their business and to realise such gains when they believe it is the best time to dispose their business. It also gives small business owners the opportunity to save for their retirement by increasing the capital value of their business.

However, the policy intent was not totally reflected in the legislation. In particular, the maximum net asset value test for discretionary trusts (with default beneficiaries that are charities or public benevolent institutions) under sub-paragraph 152-15(a) (ii) of the *Income Tax Assessment Act 1997* did not meet the policy intent. This difference from the policy intent (or an unintended consequence of the legislation) was articulated by the ATO in its interpretative decision ATOID 2002/921 (which was subsequently withdrawn following amendment to the law on 15 July 2004).

ATOID 2002/921 caused significant concern amongst tax professionals and their small business clients. The effect of ATOID 2002/921 was to make many businesses (unnecessarily) review their family trust deeds through which their small business operates and on some occasions amend their trust deeds. Such trusts became liable (in some instances) to pay stamp duty.

This submission is not requesting the Board revisit this issue, but maybe the Board could use this issue as a 'catalyst for change'. For example, where it is clear to the ATO that legislation is in conflict with the policy intent of the legislation (as expressed in Explanatory Memoranda and Ministerial Statements) or the legislation has unintended negative consequences on taxpayers, the ATO should not immediately publish its interpretation on a particular issue. The ATO should instead raise the issue with the National Tax Liaison Group's Technical Issues Management Subcommittee (TIMS), who could then follow their normal processes and either request an administrative solution (that is consistent with the policy intent) or request a legislative solution if legislative change is the only possible solution and if so, suggest to Government what priority such a legislative solution should have.

The reason that the NIA suggest the above approach is to avoid the consequences that arose out of the unexpected issue of ATOID 2002-921. Even though a request for a Private Binding Ruling (PBR) had been made on the issue, the ATO should have appreciated the impact of their interpretation and sought a "fix" to the issue rather than satisfying the PBR request. As stated above, ATOID 2002/921 caused significant angst in the community and added unnecessary compliance costs to taxpayers.

This is not to say that the NIA expects all issues of interpretation to be vetted by the TIMS for any negative ramifications. The NIA submit that it is the ATO's responsibility to determine whether the impact of its interpretation has unintended negative consequences on taxpayers and/or is inconsistent with the policy intent.

Another mechanism that could be used to ameliorate such problems occurring in the future (particularly as drafting of tax legislation is moving to a principles-based approach) is to institute "fatal flaw reviews" of proposed legislation. Such "fatal flaw reviews" would involve taxpayers and/or their representatives testing proposed legislation against their current factual situations and giving feedback to Treasury/ATO on the actual impact of the proposed legislation before the legislation is placed before Parliament. Such "fatal flaw reviews" should be done on a confidential basis, however the NIA recognises that there will be issues where the Government does not want to consult on.

In responding to the specific criteria against which the Board are seeking to evaluate the small business CGT concessions, the NIA would like to make the following additional comments:

- Division 152 gives effect to the Government policy intent, particularly after amendments to Div 152 were made in *Tax Laws Amendment (2004 Measures No. 1) Act 2004*;
- The legislation is mostly clear, simple and comprehensible, however, there are concerns over the definition of "small business" as it varies from the definition of "small business" in other areas of the same *Act* and other tax acts;
- The unintended consequences of ATO 2002/921 have now been overcome with the passage of retrospective legislation. There are currently no other unintended consequences of the Concession that the NIA is aware of;

- The legislation takes account of actual taxpayer circumstances and commercial practices. The only recommendation from the NIA is that the maximum net asset value test (\$5 million in net assets) should be reviewed on a periodic basis to ensure that the threshold does not begin to lose relevance. The other option is to align increases in the threshold with the Consumer Price Index (CPI);
- The concession is not consistent with other tax legislation, however the policy was never intended to be consistent (as it was a specific concession from the normal operation of the CGT regime). The greatest inconsistency with other tax legislation is the definition of “small business”, which varies throughout tax legislation depending on the specific policy intent of each measure. The NIA however, is not calling for a single definition of “small business”; and
- The concession now provides certainty to small business taxpayers about the CGT treatment of their business.

The NIA believes that the legislation is now effective in delivering its policy intent however, we do have some concerns over the awareness of the measure amongst some small businesses (which will be highlighted as the ATO increase their CGT compliance activities).

Yours sincerely,

Gavan Ord  
Technical Policy Manager