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GENERAL AND POLICY ISSUES

2.1 This chapter discusses three general issues and three policy issues which the Committee believes are outside TLIP's mandate. The Committee has decided not to reopen matters already discussed in earlier reviews of rewritten taxation law.

General issues

Register of pending corrections

2.2 In first reviewing the Bill, the Committee recommended that any unintended consequences arising from the legislation should be corrected on a retrospective basis irrespective of whether the taxpayer or revenue had been adversely affected.[1] The Taxation Institute of Australia (TIA) subsequently sought clarification as to whether:

> *... a register of pending corrections (or 'unintended consequences') will be on the public record and how taxpayers can ensure that pro-taxpayer corrections are also included in this register and appropriately dealt with.*[2]

2.3 TLIP responded that it would consider how such information could be made more readily available. One possibility was by including the information on the Australian Taxation Office internet web site.[3]

2.4 Further comment from stakeholders has not been forthcoming.

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1 JCPAA, *Report 356*, Recommendation 5, p. 25.

2 TIA, *Submission*, p. S568.

3 TLIP, *Submission*, p. S575.

2.5 The Committee welcomes TLIP's suggestion to place information regarding unintended consequences arising from the taxation rewrite on the internet. Such a process increases transparency. It will also prevent stakeholders from expending unnecessary effort in drawing TLIP's attention to unintended consequences that are already known and acknowledged.

2.6 However, the Committee draws a distinction between a 'register of pending corrections' and a 'register of unintended consequences'. The former indicates that action is being taken, whereas the latter could merely be an acknowledgment of the existence of unintended consequences.

2.7 The Committee is of the view that any register should be broad in content and cover the Bill and future tax law improvement legislation. It should contain a list of the unintended consequences, and include:

- the date the unintended consequence was identified;
- an indication of the severity of the consequence, for example the revenue or compliance implications;
- when it is intended to rectify the consequence in legislation; and/or
- the alternative measures being taken in the interim to address the problem.

2.8 **Recommendation 1**

The Tax Law Improvement Project should compile and maintain a publicly available register of unintended consequences arising from tax law improvement legislation. The register should include information indicating when the unintended consequence was identified, the severity of the consequence, if and when it is intended to amend the legislation, and the alternative measures being taken in the interim.

The date of effect of the Subdivision and Divisions

2.9 When TLIP provided a response to issues raised in submissions to the Committee it drew attention to the commencement date for the Subdivision and Divisions. The date of effect of the provisions, TLIP advised, was to be the 1998–99 income year and this would be effected by the inclusion of the provisions in a bill to be introduced during the 1998 spring sittings of Parliament.[4]

2.10 The Committee received no comment on the issue from stakeholders when TLIP's comments were forwarded to them.

2.11 The Committee observes that the details of the delayed provisions have not in the main proved controversial. The provisions have also been exposed to public view before the commencement of the 1998–99 income year which will assist financial advisors in providing timely advice to clients.

2.12 The Committee therefore considers it appropriate for the delayed provisions to take effect along side the other CGT provisions which come into effect for the 1998–99 income year.

The complexity of the Subdivision and Divisions

2.13 The complexity of the proposed legislation was criticised by the TIA on two grounds:

- the complex nature of the rules and concepts associated with the Subdivision and Divisions; and
- the lack of clarity of language.[5]

4 TLIP, *Submission*, p. S575.

5 TIA, *Submission*, pp. S563–4, S566.

2.14 TLIP responded in the following terms:

- In regards to Division 123 and Subdivision 118-F, the underlying policy was given legislative effect within the last twelve months and so it was not appropriate for that policy to be interfered with. Further, any complexity was a result of ensuring that the concessions were only available to those for whom they were intended;

- In regards to Division 138, a person with a good grasp of other CGT provisions should have little difficulty in applying the provisions. In addition, much of the complexity arose from providing taxpayers 'with greater certainty ... and from the inclusion of concessions and "safe harbours" sought by the tax professionals.'[6]

2.15 The Committee acknowledges that the proposed legislation contains some level of complexity, but accepts TLIP's responses on the matter.

Specific policy issues

Division 123

2.16 Division 123 deals with roll-overs for certain disposals of assets of a small business where new business assets are acquired. The effect of the Division is to defer the determination of the capital gain associated with the disposal of an asset of a small business until the disposal of the new assets.[7]

Discretionary trust rules

2.17 Clause 123–50 restricts the provision of roll-over relief to entities with a net value of assets, including the assets of any connected entities, of $5 million or less. Clause 123–60 defines the meaning of the term 'connected'.

6 TLIP, *Submission*, pp. S571–3.

7 *Explanatory Memorandum*, p. 7.

2.18 The TIA criticised subclause 123-60(5):

> *Because of its extreme breadth having the apparent effect of operating to deem the assets of any beneficiary under a family discretionary trust to be counted under the $5,000,000 test, it is likely that the courts will seek to limit the operation of this provision.*[8]

2.19 TLIP responded that the proposed provisions maintained the existing law which was a reflection of a recent Government policy decision. The rules were considered 'necessary to ensure that arrangements allowing unintended access to the small business CGT rollover provisions were not effective.'[9]

2.20 The Committee acknowledges that the existing provisions were only recently enacted by Parliament. However, the effect of subclause 123-60(5) appears to be extraordinarily broad and difficult to comply with.

2.21 For example, it appears that the relevant assets of each potential beneficiary of a discretionary trust would have to be taken into account in determining whether a trust satisfied the $5 million threshold test. Where the discretionary trust has many potential beneficiaries, which may be likely, then the trustee of the trust would have to determine the relevant assets of each of those beneficiaries. It could be difficult for the trustee to determine this information.

2.22 Another example of the potential scope of the provision is where two discretionary trusts have at least one common beneficiary. Where one of the discretionary trusts seeks roll-over relief, it appears that in addition to the relevant assets of any potential beneficiaries being included in the $5 million threshold test, the relevant assets of the other discretionary trust must also be taken into account. Again, it could be difficult for the trustee to determine this information.

2.23 Compliance issues of the sort described above are of great concern to the Committee. While the issue discussed is outside of TLIP's mandate, the Committee considers that the matter is of sufficient importance to warrant the following recommendation.

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8 TIA, *Submission*, p. S565.

9 TLIP, *Submission*, p. S571.

2.24 **Recommendation 2**

The operation of subclause 123-60(5) be examined to determine whether the provision can be made more appropriate in its scope and to overcome potential compliance difficulties.

Division 138

2.25 Division 138 is designed to overcome the timing advantages that can arise when value is shifted from one commonly owned company to another (for example, by transferring an asset at less than market value). This could lead to the deferral of a capital gain or the bringing forward of a capital loss.

De minimus threshold exemption

2.26 The TIA believed that Division 138 was difficult to comprehend because of the 'overwhelming complexity of both the concepts involved ... and also the potential calculations required'. The TIA suggested that the Division would potentially apply to large corporate groups with access to specialist advisors as well as to individual taxpayers who own interests in more than one company. Citing the precedent of a *de minimus* threshold test in Division 140, the TIA recommended the inclusion of a similar threshold exemption 'where there has been a relatively insignificant and/or inadvertent value shift between underlying companies'.[10]

2.27 TLIP responded that the inclusion of a *de minimus* provision would add complexity to the legislation. This was because it would need to be applied across the existing concessional arrangements which allow most depreciable plant to be transferred at residual value rather than market value. Assets would need to be valued, thus increasing compliance and administration costs. In addition, complex anti-avoidance provisions would be needed.[11]

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10 TIA, *Submission*, pp. S566–7.

11 TLIP, *Submission*, p. S573.

2.28 The *de minimus* provision in Division 140, TLIP argued, was put in place to 'balance potential compliance costs and the need to safeguard the revenue.' It simplified the underlying rules because it removed the requirement for detailed exemptions or concessions for arrangements such as public floats and employee share plans. 'Such arrangements did not arise in a Division 138 context', TLIP concluded.[12]

2.29 The Committee accepts TLIP's arguments that a *de minimus* provision in Division 138 is unnecessary.

Common ownership time

2.30 The TIA raised the issue of the impact of the time when companies become a wholly-owned group company as an outcome of the operation of the Division:

> *While it is accepted that differing cost base adjustments should arise depending on when the transferor company became a wholly-owned group company there is no logic as to why there should be different ... proposed Division 138 results depending on when the transferee joined the group.*[13]

2.31 The TIA maintained that at issue was the need to correct a 'technical error/anomaly' which had been present in the 1936 Act, and so this was not a policy issue outside TLIP's mandate.[14]

2.32 TLIP acknowledged that the time at which a transferee company joined the group could affect the cost base adjustments that were required. There were advantages where the transferee company had been a group company for some time compared to the situation if it was a recently acquired shelf company. From a policy viewpoint there was a case for equality of treatment, but any change could result in inappropriate advantages for the recently acquired company compared to the long held company. TLIP concluded that, either way, there were revenue implications which took the issue beyond its charter.

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12 TLIP, *Submission,* p. S573.

13 TIA, *Submission,* p. S567.

14 TIA, *Submission,* p. S567.

Trading stock

2.33 The TIA raised concerns in its submission regarding the interaction between Division 138 and section 118–25 of the rewritten taxation legislation. The TIA supported the comments which were made by the Corporate Taxation Association when the Committee originally reviewed the Bill.[15]

2.34 The Committee has discussed this issue in its *Report 356*,[16] and has decided to not reopen the matter.

15 TIA, *Submission*, pp. S567–8.

16 JCPAA, *Report 356*, pp. 39–40.