THE SENATE

CANBERRA ACT 2600

SELECTION OF BILLS COMMITTEE

REPORT NO. 8 of 2007

10 May 2007

MEMBERS OF THE COMMITTEE

Senator Stephen Parry (Government Whip, Chair)

Senator George Campbell (Opposition Whip)

Senator Andrew Bartlett (Australian Democrats Whip)

Senator Fiona Nash (The Nationals Whip)

Senator Rachel Siewert (The Australian Greens Whip)

Senator Steve Fielding (The Family First Whip)

Senator the Hon. Eric Abetz

Senator Joe Ludwig

Senator Julian McGauran

Senator Ruth Webber

Secretary: Richard Pye
☎ 6277 3020

SELECTION OF BILLS COMMITTEE

REPORT NO. 8 OF 2007

1. The committee met in private session on Thursday, 10 May 2007 at 11.03 am.

2. The committee resolved to recommend—That—

   (a) the ***provisions*** of the Communications Legislation Amendment (Content Services) Bill 2007 be ***referred immediately*** to the Environment, Communications, Information Technology and the Arts Committee for inquiry and report by 12 June 2007 (see appendix 1 for a statement of reasons for referral);

   (b) the ***provisions*** of the Australian Centre for International Agricultural Research Amendment Bill 2007 be ***referred immediately*** to the Foreign Affairs, Defence and Trade Committee for inquiry and report by 12 June 2007 (see appendix 2 for a statement of reasons for referral); and

   (c) the ***provisions*** of the Tax Laws Amendment (2007 Measures No. 3) Bill 2007 and the Tax Laws Amendment (Small Business) Bill 2007 be ***referred immediately*** to the Economics Committee for inquiry and report by 6 June 2007 (see appendix 3 for a statement of reasons for referral).

The committee recommends accordingly.

3. The committee deferred consideration of the following bill to its next meeting:

   - Repatriation of Citizens Bill 2007.

(Stephen Parry)
Chair
10 May 2007

APPENDIX 1

THE SENATE

CANBERRA ACT 2600

SELECTION OF BILLS COMMITTEE

Proposal to refer a bill to a committee

Name of bill:
Communications Legislation Amendment (Content Services) Bill 2007

Reasons for referral/principal issues for consideration:
Examination of the bill as necessary.

Possible submissions or evidence from:

Committee to which bill is to be referred:
Environment, Communications, IT and the Arts

Possible hearing date (s):

Possible reporting date: 12 June 2007

(signed) ....

Whip/Selection of Bills Committee member

APPENDIX 2

THE SENATE

CANBERRA ACT 2600

SELECTION OF BILLS COMMITTEE

Proposal to refer a bill to a committee

Name of bill: Australian Centre for International Agricultural Research Amendment Bill 2007

Reasons for referral/principal issues for consideration:
Examination of the bill as necessary.

Possible submissions or evidence from:

Committee to which bill is to be referred: Foreign Affairs, Defence and Trade

Possible hearing date (s):

Possible reporting date: 12 June 2007

(signed) ....

Whip/Selection of Bills Committee member

APPENDIX 3

THE SENATE

CANBERRA ACT 2600

SELECTION OF BILLS COMMITTEE

Proposal to refer a bill to a committee

Name of bill: Tax Laws Amendment (2007 Measures No.3) Bill 2007
Tax Laws Amendment (Small Business) Bill 2007

Reasons for referral/principal issues for consideration:
See attached.

Possible submissions or evidence from:

Committee to which bill is to be referred: Economics

Possible hearing date (s):

Possible reporting date: 6 June 2007

(signed) ....

Whip/Selection of Bills Committee member

TAX LAWS AMENDMENT (2007 MEASURES No. 3) BILL 2007

Distributions to entities connected with a private company and related issues

Objectives

The amendments will reduce the extent that taxpayers can trigger a deemed dividend inadvertently under Division 7A of the *Income Tax Assessment Act 1936* (about non-commercial loans) and reduce compliance costs for taxpayers, especially for small businesses which use a private company structure.

Existing law and proposed changes

Division 7A is designed to prevent private companies from making tax-free distributions of profits to shareholders (or their associates). Unless they come within specified exclusions, advances, loans and other credits to shareholders (or their associates) are treated as assessable dividends to the extent that there are realised or unrealised profits in the company. When a deemed dividend arises under Division 7A, the private company's franking account is debited and the deemed dividend is taxable in the hands of the shareholder or associate, but without access to a franking credit to offset the tax paid by the company.

The proposed changes will reduce the double-penalty nature of Division 7A by removing the automatic debiting of the company's franking account when a deemed dividend arises. The Commissioner of Taxation will also be provided with a general discretion to disregard a deemed dividend that has arisen because of an honest mistake or inadvertent omission by a taxpayer. A range of other technical amendments will also be made to the rules to provide more flexibility for taxpayers, including allowing loans to be refinanced without a deemed dividend being triggered, and an amendment to exempt from fringe benefits tax (FBT), loans that meet the Division 7A criteria.

Context of changes: The accounting professional bodies and tax practitioners made representations to Government outlining their concerns on the unduly harsh nature of Division 7A, which provided no opportunity for taxpayers to correct unintended errors that gave rise to a deemed dividend.

Date of effect: In the main, the changes take effect from 1 July 2006. However, the Commissioner's general discretion is retrospective and can be utilised in respect of 2001-02 and later income years. The FBT amendments apply from 1 April 2007.

Announced: The changes were announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 089 on 6 December 2006.

Financial impact: The cost to revenue of these amendments is unquantifiable but expected to be minimal against the forward estimates.

Compliance cost impact: The measures will reduce ongoing compliance costs for private companies, though there will be a small transitional cost.

Simplified Superannuation — transitional non-concessional contributions cap

Objectives: To ensure that certain superannuation contributions (such as those made by a friend) made prior to 1 July 2007 are appropriately subject to a contribution cap during the transitional period for the *Simplified Superannuation* reforms.

Existing law and proposed changes

The non-concessional contributions cap, which limits the amount of non-concessional (previously know as 'undeducted') contributions that a person can make from 10 May 2006 into the concessional superannuation environment, does not include certain contributions made on behalf of someone else (such as those made by a friend). Whilst that contribution is currently included in the assessable income of an entity and is caught by the concessional contributions cap, this cap does not commence until 1 July 2007.

This means such contributions made prior to 1 July 2007 are not subject to a contribution cap during the 10 May 2006 to 30 June 2007 transitional period for *Simplified Superannuation.*

This measure will include in the calculation of non-concessional contributions for the transitional period such contributions made after 6 December 2006. This will include contributions made by friends for each other but will not include contributions that are not included in the assessable income of the entity, such as spouse contributions, contributions on behalf of children, Government co-contributions, or contributions made on behalf of an employee (as these are, in one way or another, already limited or capped during that period).

Such contributions will therefore be subject to the non-concessional contributions cap in that period.

Date of effect: The measure applies to such contributions made after 6 December 2006 and before 1 July 2007. The Treasurer's Press Release No. 131 of 2006 stated that the Government would act to address any avoidance activities that are undertaken in the *Simplified Superannuation* system, with the date of effect of any such measures to be backdated to 7 December 2006 (the date of introduction of the first *Simplified Superannuation* Bills into the Parliament).

Announced: These changes were announced in Minister for Revenue and Assistant Treasurer's press release No. 037 of 24 April 2007.

Financial impact: Nil. This is a revenue protection measure necessary for the implementation of the *Simplified Superannuation* reforms as intended.

Compliance cost impact: Nil.

Capital gains of testamentary trusts

Objectives

This measure will ensure that an income beneficiary of a resident testamentary trust (a trust that arises on someone's death) need not be assessed on capital gains of the trust if, under the terms of the trust, they would not receive the benefits of the capital gains.

Existing law and proposed changes

A trust is not a separate taxable entity; either the trustee or the beneficiaries (or a combination of the trustee and the beneficiaries) will be assessed on the net income of the trust (that is, the trust's taxable income). Under the current income tax laws an income beneficiary who is entitled to a share of a trust's income is generally assessed on a similar share of the trust's net income. If the net income includes capital gains, the income beneficiary may be assessed on those gains even if, under the terms of the trust, they are not entitled to benefit from them.

This measure will allow the trustee of a resident testamentary trust to choose to be assessed on the capital gains which would otherwise be assessed to an income beneficiary (or the trustee on their behalf). The trustee will be able to make the choice if, under the terms of the trust, the income beneficiary cannot benefit from the capital gains. The consequence of making this choice is that the capital gains will be assessed to the trustee in their capacity as trustee of the trust. If the choice is made, tax will in effect be borne by the capital beneficiaries of the trust, who will ultimately benefit from the capital gains.

In some circumstances, the capital beneficiaries of the trust may consider themselves losers under this measure. This is because under the current law, they do not bear the tax on trust capital gains without their consent. Under this measure the trustee may make a choice without the consent of the capital beneficiary. However, in making a choice, the trustee should take into account their fiduciary duties to both the income and capital beneficiaries of the trust.

Context of changes: The Trustee Corporations Association of Australia had raised concerns that the current approach for allocating tax liability for capital gains made by testamentary trusts can be impractical and result in inequitable outcomes.

Date of effect: This measure will apply to the 2005-06 and later income years.

Announced: This measure was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 74 of 17 October 2006.

Financial impact: The financial impact of this measure is unquantifiable but is expected to be low.

Compliance cost impact: Nil for implementation and $335,000 reduction in on-going compliance costs.

Taxation of superannuation death benefits to non-dependants of defence personnel and police killed in the line of duty

Objectives

To ensure that the non-dependant beneficiaries of the members of the Australian Defence Force or any Australian police force, or Australian Protective Service Officers, killed in the line of duty, pay no more tax on a superannuation death benefit than dependant beneficiaries.

Existing law and proposed changes

Under existing law, superannuation death benefits paid to dependants of a deceased person are taxed more concessionally than if they are paid to non-dependants.

From 1 July 2007, lump sum superannuation death benefits will be tax free without limit if paid to dependants and taxed concessionally if paid to non-dependants, as a result of the introduction of the *Simplified Superannuation* reforms.

This means that non-dependant beneficiaries of defence personnel and police killed in the line of duty, such as parents and siblings, pay a higher rate of tax on lump sum superannuation death benefits than dependant beneficiaries, such as spouses.

The proposed law will align the tax treatment of lump sum superannuation death benefits paid to non-dependants with that applying to dependants where the deceased was killed in the line of duty as a member of either the Australian Defence Force, or any Australian police force, or as an Australian Protective Service Officer.

The Government will also be making ex gratia payments (equivalent to additional tax paid) to eligible non-dependants who received a lump sum superannuation death benefit payment over the period from 1 January 1999 to 30 June 2007. The legislation recognises that this is an appropriate exercise of the Executive Power of the Commonwealth.

Context of changes: The proposed amendments recognise the valuable role played by defence personnel and police in maintaining the safety and security of the community and the country, and provide support to their non-dependant beneficiaries.

Date of effect: These amendments are to apply to lump sum superannuation death benefit payments received in the 2007-08 income year and later income years.

Announced: This measure was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 032 of 5 April 2007.

Financial impact: These amendments will have a cost to revenue of $0.2 million per year ongoing.

Compliance cost impact: Low. Normal record keeping requirements will apply.

Thin capitalisation rules

Objective

To extend by one year (from three to four years) a transitional period during which taxpayers may elect to use either the current or former accounting standards in making calculations required under the thin capitalisation rules.

Existing law and proposed changes

Under the thin capitalisation rules, the recognition and valuation of an entity's assets, liabilities and equity must be determined in accordance with Australian accounting standards.

On 1 January 2005, Australia adopted equivalents to *International Financial Reporting Standards* (AIFRS), replacing the previous *Australian Generally Accepted Accounting Principles* (AGAAP). Differences between AIFRS and AGAAP in the recognition and/or valuation of certain assets and liabilities mean that some entities will have a significantly altered thin capitalisation position if required to apply AIFRS for thin capitalisation purposes.

In view of this, the Treasurer announced (Press Release No. 002 of 24 January 2005) that a three-year transitional period would apply in respect of the application of AIFRS to the thin capitalisation provisions, such that entities could elect during this time, on an annual basis, to either use AIFRS or continue using AGAAP to calculate their thin capitalisation position.

The transitional period applies to an entity from its first income year commencing on or after 1 January 2005. The press release stated that during the transitional period the Government would examine whether the existing thin capitalisation rules are appropriate following the adoption of AIFRS.

The transitional period begins expiring from 31 December 2007 (for taxpayers with balance dates of 31 December). While substantial progress has been made in determining the nature and scale of the impact of the adoption of AIFRS on thin capitalisation calculations, it is unlikely that any permanent changes to the rules can be developed, consulted on and legislated before the expiration of the current transitional period.

It is therefore considered prudent to extend the transitional period by one year.

Context of changes: The thin capitalisation rules in Division 820 of the *Income Tax Assessment Act 1997* are designed to ensure that both Australian and foreign-owned multi-national entities do not allocate an excessive amount of debt to their Australian operations, thereby, moving company profits to lower taxing jurisdictions. The rules operate to disallow a proportion of otherwise deductible finance expenses (ie, interest) where the debt used to fund the Australian operations exceeds certain thresholds.

Entities may determine their thin capitalisation position using various tests – the 'safe harbour' test, the 'arm's length' test and the 'worldwide gearing' test. The tests require the calculation of an entity's assets, liabilities and/or equity capital.

Date of effect: This amendment is to apply from Royal Assent.

Announced: This measure has not previously been announced.

Financial impact: There is no revenue impact as a result of this amendment.

Compliance cost impact: This amendment will involve minimal additional compliance costs.

Repeal of dividend tainting rules

Objectives

To repeal the dividend tainting rules and make two consequential amendments as part of the ongoing implementation of the simplified imputation system.

Existing law and proposed changes

The dividend tainting rules currently prevent distributions from share capital accounts and asset revaluation reserves from being frankable.

The amendment will repeal the dividend tainting rules.

- A consequential amendment will be made to prevent distributions from share capital accounts (including tainted share capital accounts) from being frankable.
- A second consequential amendment will modify a general anti-avoidance rule that applies in relation to the imputation system so that, when considering whether to apply the rule, the Commissioner of Taxation can take into account whether a distribution is sourced directly or indirectly from unrealised or untaxed profits.

Context of changes: The dividend tainting rules were introduced in 1995 to prevent corporate taxpayers from taking advantage of the inter-corporate dividend rebate to make tax-free distributions to corporate shareholders or transferring franking credits to shareholders by inappropriate means. The rules also provide a mechanism to ensure that a return of capital from a tainted share capital account is treated as an unfranked distribution.

As a result of the removal of the inter-corporate dividend rebate under the simplified imputation system and the introduction of the consolidation regime, the schemes that the dividend tainting rules were primarily directed at preventing can no longer be entered into. However, business and professional groups have raised concerns that the rules may inadvertently be triggered by the accounting entries required under the Australian Equivalent of the *International Financial Reporting Standards* (AEIFRS).

Date of effect: The changes will apply in relation to distributions made on or after 1 July 2004. This will ensure that taxpayers do not inadvertently trigger the dividend tainting rules by accounting entries required under AEIFRS.

Announced: This measure was announced in the Minister of Revenue and Assistant Treasurer's Press Release No. 080 of 9 November 2006.

Financial impact: Negligible.

Compliance cost impact: Nil.

Clarification of exemption from interest withholding tax

Objectives

This measure will ensure that the interest withholding tax (IWT) exemption remains consistent with the Government's original policy intent. This was to ensure that Australian business does not face a restrictively higher costs of, or constrained access to, capital as a result of a shift in the burden of IWT (from the foreign lender to the Australian borrower). The amendments also enhance the integrity of the tax system.

Existing law and proposed changes

Since March 2005, the exemption from IWT has been available for debentures and debt interests, provided those instruments satisfied the public offer test and other requirements. The extension of the exemption to debt interests unintentionally broadened the scope of eligibility for the IWT exemption to financial instruments that the Government had not intended to make eligible for exemption.

This measure restores the original purpose of the 2005 amendments, by limiting eligibility for exemption to non-debenture debt interests that are non-equity shares (including those subject to the related schemes rules in Division 974 of the *Income Tax Assessment Act 1997*); syndicated loans or specified by regulation as eligible for exemption.

Syndicated loans have been made eligible for exemption due to their emergence as a key instrument used by Australian borrowers to raise capital via off-shore markets. Industry submissions have indicated that were syndicated loans ineligible for exemption, Australian borrowers would be required to document such loans as debentures, which are less attractive to foreign lenders and necessitate additional transaction costs for the borrower.

It will still be necessary for the debt interests eligible for exemption to pass the public offer test. The public offer test also continues to apply in the case of syndicated loans, however the test has been modified to apply to syndicated loan facilities, thereby accommodating existing market practices and providing certainty to financial markets.

The amendments also ensure appropriate transitional arrangements are in place to avoid retrospective exclusion of debt interests arising from financial arrangements entered into in reliance on the law as it stood after March 2005.

Context of changes: The amendments were previously part of Schedule 2 to the Tax Laws Amendment (2006 Measures No. 7) Bill 2006, but were removed from that Bill before its passage. The Schedule was removed from the Bill because of the identification of additional issues following its introduction that warranted further consideration. Consideration at this stage avoided ongoing industry uncertainty associated with delaying examination of the issues.

Date of effect: 7 December 2006

Announced: Announced by the Minister for Revenue and Assistant Treasurer in Press Release No. 091 of 7 December 2006.

Financial impact: Nil

Compliance cost impact: Nil

Specific deduction for investments in forestry managed investment schemes and secondary market trading of interests

Objectives

To provide certainty for investors by inserting a specific deduction into the *Income Tax Assessment Act 1997* (ITAA 1997) which will provide a 100 per cent deduction for an initial investment in forestry managed investment schemes (MIS) and a 100 per cent deduction for the ongoing costs, at the time when the investor pays the amounts, provided a 70 per cent 'direct forestry expenditure' test and certain other tests are satisfied.

Existing law and proposed changes

The deductibility of investors' contributions to forestry MIS is currently determined under the general deduction provision of the ITAA 1997 (section 8-1). In addition, an immediate deduction may be claimed for funds contributed in one year for 'seasonally dependent agronomic activities' undertaken during the following year. This special '12 month prepayment rule' is due to expire on 30 June 2008.

The test in section 8-1 involves considerable uncertainty as to whether specific expenses will qualify as a deduction, either because the investor may not be carrying on a business or because the investor's interest in the scheme is capital rather than revenue in nature.

Under the existing law, forestry MIS companies must include the prepaid expenditure in assessable income in the year in which the deduction is first available to the investor and not when the work is done on the investor's behalf.

Under the new provision, investors in forestry MIS will be eligible for a 100 per cent tax deduction for their contributions in the year that they pay amounts under the scheme, provided that (amongst other requirements) at least 70 per cent of the expenditure is attributable to establishing, tending and felling trees. Investors will not

have to demonstrate that they are carrying on a business to claim the deduction, or that the amount is on revenue account.

Interest and borrowing costs, and insurance costs, paid by an investor will not be covered by the statutory deduction provision and will continue to be deductible under the relevant provisions of the Tax Acts (e.g. section 8-1 and section 25-25 of ITAA 1997, respectively), provided the relevant tests for those provisions are met.

The objects clause to the legislation makes it clear that the concession is directed towards new investment in commercial plantation forests that are to be tended and felled (to help achieve the industry's goals as set out in *Plantations for Australia: the 2020 Vision*).

There will be an integrity rule requiring that in determining the value of expenditure directly related to forestry, the market value be substituted where the parties are not dealing at arm's length and the expenditure differs from the market value.

The new provision retains the rule that MIS managers must include the investors' contributions in assessable income in the year in which the deduction is first available to the investor.

The Government supports secondary markets for forestry MIS interests to introduce pricing information into the market and to increase liquidity. This should in turn increase the financial transparency of forestry MIS investments. Accordingly, trading of existing and future forestry MIS interests will be permitted subject to integrity rules, and rules which address issues of tax symmetry between deductions and proceeds. Specifically the legislation:

- inserts a four year holding period rule and an arms' length pricing rule into the ITAA 1997 for initial investors that dispose of forestry MIS interests prior to harvest;
- requires the initial investor's sale and harvest proceeds to be treated on revenue account to match the treatment of the expenditure; and
- inserts rules into the ITAA 1997 and the ITAA 1936 to provide certainty for investors that acquire forestry MIS interests in secondary market trading and subsequently receive sale or harvest proceeds. The secondary investor's proceeds from sale and harvest are to be on revenue account to the extent that they 'recoup' prior forestry deductions. If held on capital account, the remaining proceeds will be subject to a modified CGT treatment in addition to the matching revenue treatment. If the secondary investor holds the forestry scheme interest as an item of trading stock, the balance of the proceeds will be included in assessable income.

Context of changes: As a result of developments in case law, the ATO has issued a ruling indicating that investors' contributions to registered agricultural MIS are capital in nature and thus not deductible under section 8-1. Accordingly, the Government has decided to provide certainty to investors and industry by providing amending the law to include a specific deduction for contributions to forestry MIS.

New withholding arrangements for managed fund distributions to foreign residents

Objective

To improve the efficiency of the Australian managed funds industry in respect of the collection of tax from distributions to foreign residents.

Existing law and proposed changes

Under the existing law, a managed fund that makes a distribution of income (other than dividend, interest or royalty income) to a foreign resident must withhold at rates varying from 29 to 46.5 per cent, depending upon whether the foreign resident is an individual, company, trust or foreign superannuation fund.

Because managed funds do not usually have this information, it is difficult for them to manage these withholding obligations.

In addition, it is common in the industry for managed fund distributions to be paid through an Australian custodian. Under the existing law, there is uncertainty about whether the managed fund or the custodian has the obligation to withhold.

This uncertainty is addressed by the proposed changes by requiring withholding at a single rate — the company tax rate — on distributions. In addition, the obligation to withhold will only be imposed upon the entity that makes the distribution to the foreign resident (which would be the Australian custodian, if the payment is made through such an entity).

The investor is able to claim a credit for the amount withheld when they lodge an Australian income tax return to determine their final tax liability.

Date of effect: The changes will apply to income years beginning on or after the 1 July following the date on which the Act receives Royal Assent.

Announced: The measure was announced in the Treasurer's Press Release No. 39 of 9 May 2006 as part of the 2006-07 Budget.

Financial impact: The measure is expected to lead to an additional $10m - $15m per annum in revenue over the forward estimates period.

Compliance cost impact: On balance, there will be an overall reduction in compliance costs as the cost of implementing systems changes and managing ongoing record keeping obligations are far less than the cost that the affected entities would otherwise have had to bear to make enquiries about the nature of foreign residents as individuals, companies, trusts or complying superannuation funds.

Date of effect: The amendments apply to amounts paid by an investor under a scheme on or after 1 July 2007 (provided that no other amounts were paid by any investor under the scheme before that date).

Announced: The specific deduction was announced by the Minister for Revenue and Assistant Treasurer and Minister for Fisheries, Forestry and Conservation in a joint Press Release No. 097 of 21 December 2006. The secondary markets measure was announced by the Minister for Revenue and Assistant Treasurer & the Minister for Fisheries, Forestry and Conservation as part of the 2007-08 Budget.

Financial impact: Over the forward estimates period, there is expected to be no cost to revenue from these changes in 2007-08 and 2008-09. There is expected to be a revenue gain of $44 million in 2009-10 and a revenue loss of $246 million in 2010-11.

Compliance cost impact: These amendments will involve some additional compliance costs, as MIS promoters will need to demonstrate that they meet the aforementioned limitations for a deduction to be allowable.

Australian trust distributions to non-resident trustees

Objectives

To ensure that the ATO can collect tax from foreigners effectively.

Existing law and proposed changes

Under the existing law, a trustee is not liable to pay tax on a non-resident trustee beneficiary's share of the net income of the trust (the trust's taxable income).

Under the proposed changes, a trustee is liable to pay tax on a non-resident trustee beneficiary's share of the net income of the trust attributable to an Australian source. There are exclusions for widely-held managed investment trusts and Australian intermediaries.

Context of changes: The purpose of the changes is to improve the integrity of the tax system in relation to the collection of tax from non-resident trustee beneficiaries.

Date of effect: The proposed changes apply to income years starting on or after 1 July 2006.

Announced: The measure was announced in the Treasurer's Press Release No. 039 of 9 May 2006 as part of the 2006-07 Budget.

Financial impact: The gain to revenue from these changes is estimated to be $250 million in 2007-08, $270 million in 2008-09 and $280 million in 2009-10.

Compliance cost impact: This measure is expected to result in a small increase in compliance costs for trustees with foreign trustee beneficiaries.

TAX LAWS AMENDMENT (SMALL BUSINESS) BILL 2007

ALIGNING CONCESSIONS FOR SMALL BUSINESS

Objectives

The objective of this Bill is to standardise the primary eligibility criterion across the small business tax concessions, and therefore reduce the compliance costs for small businesses.

Existing law and proposed changes

Separate eligibility tests currently exist for the goods and services tax (GST), the simplified tax system (STS), capital gains tax (CGT), fringe benefits tax (FBT) and pay as you go (PAYG) instalments, small business concessions.

This Bill amends the income tax law to create a single definition of small business based on an aggregated turnover of less than $2 million per year. An entity that satisfies this test will be a 'small business entity' and will be able to utilise a range of small business concessions (noting that they may still also need to meet other exiting eligibility criteria, not related to business size, depending upon the concession they wish to utilise).

An entity carrying on a business will satisfy this definition if its aggregated turnover in the previous income year was less than $2 million, or if its aggregated turnover, for the current year, is likely to be less than $2 million. Small business entities can alternatively gain access to many of the concessions if its aggregated turnover, worked out as at the end of the income year is less than $2 million.

Currently, both the STS and the small business CGT concessions contain separate grouping rules which are designed to stop larger businesses from artificially splitting their operations to gain access to the concessions. However, while these rules are similar they vary in a number of ways. This Bill aligns the two sets of grouping rules to apply a single concept within aggregated turnover definition.

Existing eligibility thresholds for accessing CGT, FBT and PAYG instalments concessions will also be retained for those entities that do not meet the new small business entity criteria but who should continue to be eligible for those concessions.

Some other important small business measures are included in this Bill, including:

- an increase in the CGT small business concessions threshold (the 'maximum net asset value test') from $5 million to $6 million;
- extension of the roll-over relief available under the uniform capital allowance system to any business with a turnover of less than $2 million who choose to

deduct amounts for depreciating assets under the simplified depreciation rules for small businesses;

- an increase in the goods and services tax cash accounting threshold from $1 million to $2 million; and
- an increase in the base assessment instalment income threshold for full self assessment taxpayers accessing PAYG instalments based on GDP-adjusted notional tax from $1 million to $2 million.

These changes, together with the new small business entity framework, significantly increase the ability of small businesses to access various small business concessions and reduce the compliance costs of businesses wishing to access these concessions.

Context of changes

Currently, the tax law contains a number of special arrangements for smaller businesses (variously defined), which are often loosely referred to as 'small business concessions'. Each concession has its own set of eligibility criteria, based on the particular group being targeted. The criteria are tailored to the specific characteristics, policy objectives and constraints of each particular regime.

Under the new small business framework, eligibility for the small business concessions will be based on a turnover threshold. Small businesses that meet the turnover threshold will be able to access a range of small business concessions (provided they satisfy the existing additional conditions specific to each concession that aren't related to business size).

The increase in the maximum net asset value test, the increase in the GST cash accounting threshold, and the extension of the roll-over relief are designed to increase the number of small businesses able to access the concessions. The increase in the base assessment instalment income threshold for PAYG instalment purposes is designed to overcome a transitional issue discussed below.

Date of effect

These amendments generally apply from the 2007-08 income year (and from 1 April 2007 for FBT).

The main exception is the change to allow small businesses to access PAYG instalments on the basis of GDP-adjusted notional tax, which will apply from the 2009-10 income year. The deferred application date is due to ATO systems limitations that make them unable to accommodate the changes in the short-term. To ensure that small businesses can access a similar concession in the interim, the current theshold test applying to PAYG instalment concessions (base assessment instalment income) will be increased from $1 million to $2 million. It is expected that this will largely cover the same entities that would have been eligible for the PAYG instalment concession under the small business test.

Announced

The 2006-07 Budget announced measures to simplify access to concessions for small business.

Further, on 13 November 2006, the Treasurer and the Minister for Small Business and Tourism announced that a single definition of small business would be introduced that would align the concept of turnover as it applied to all small business concessions. This announcement subsumed the budget announcement.

Financial impact

The cost to revenue of these measures is estimated to be $7 million in 2007-08, $137 million in 2008-09 and $151 million in 2009-10.

Compliance cost impact

This measure will reduce ongoing compliance costs for many small businesses because they will only have to meet one eligibility threshold (for determining business size) to gain access to multiple concessions.