Chapter 2

The bill

2.1 The main objective of the *Tax Laws Amendment (Small Business) Bill 2007* is to make it simpler for small business to determine eligibility for small business tax concessions. It does this by establishing a single definition of a small business entity (Schedule 1). The bill also implements several 2006–07 Budget announcements:[1]

- Schedule 2 increases the Goods and Services Tax (GST) accounting threshold applicable to small businesses' tax obligations;
- Schedule 3 redefines the simplified tax system (STS) to include small business entities;
- Schedule 4 increases the Capital Gains Tax (CGT) asset threshold for small businesses;
- Schedule 5 extends the Fringe Benefit Tax (FBT) car parking exemption to small business entities;
- Schedule 6 extends the base assessment instalment income threshold for full self assessment STS taxpayers from $1 million to $2 million; and
- Schedule 7 extends the roll-over relief available under the uniform capital allowance system.

2.2 The cost to revenue of the bill's measures is estimated to be $7 million in 2007–08, $137 million in 2008–09 and $151 million in 2009–10. All measures will take effect from 1 July 2007, except for the fringe benefits tax amendments which are backdated to 1 April 2007 and the increased threshold for PAYG instalments which will apply from the 2009–10 income year.[2]

Schedule 1—The 'small business entity test'

2.3 Schedule 1 of the bill amends the *Income Tax Assessment Act 1997* to provide a single definition of a small business entity for the purpose of accessing any of the small business tax concessions. The 'small business entity test' requires that the entity must 'carry on a business' and have an aggregated turnover of less than $2 million.

2.4 Currently, the law contains a number of 'small business concessions', each of which has its own set of eligibility criteria. Small business concessions for:

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1 See The Hon. Peter Costello MP, Treasurer, 2006–07 Budget Speech, 9 May 2006, pp. 5–6. http://www.budget.gov.au/2006-07/speech/download/Budget_Speech.pdf (accessed 16 May 2007).

2 Explanatory Memorandum (EM), p. 3.

- the Simplified Tax System (STS) are based on turnover as measured by the value of supplies made in the ordinary course of carrying on a business;
- the Goods and Services Tax (GST) are based on turnover, excluding the value of input taxed and certain other supplies;
- the Capital Gains Tax are based on net asset value as measured by the sum of the market value of the assets minus liabilities related to those assets and provisions for certain future liabilities;
- the Fringe Benefits Tax are based on total ordinary income plus statutory income; and
- Pay As You Go (PAYG) instalments are based on base assessment instalment income.

2.5 The Explanatory Memorandum (EM) explains that multiple eligibility criteria for the various concessions are 'a source of complexity and unnecessary compliance costs for small business'.[3] Accordingly, the bill's single test for eligibility 'will reduce compliance costs for many small business entities because they will only have to meet the standard eligibility threshold to gain access to multiple concessions'.[4] Businesses must also meet any current criterion for concessions relating to issues other than this 'small business entity test'.

2.6 The $2 million 'small business entity test' may be measured in any one of three ways. First, an entity may be considered a small business if its aggregated turnover on the previous year of income was less than $2 million, regardless of the entity's likely or actual aggregated turnover for the current year.[5] Second, an entity may be considered a small business if its aggregated turnover on the current income year is likely to be less than $2 million, regardless of the corresponding figure for the previous year. This test is based on the entity's state of affairs as at the first day of the income year and whether, 'on the balance of probabilities', it is more likely than not that its turnover will be under $2 million.[6] Third, an entity may classify as a small business if the entity's aggregated income for the current year is less than $2 million. This is based on the entity's actual aggregated turnover for the income year in which the concessions are sought.[7] Entities that satisfy only this third test are unable to retrospectively access concessions under PAYG instalments and GST.

2.7 Notwithstanding this exemption, businesses that satisfy the 'small business entity test' will be eligible for a total of 12 small business concessions. These are: the CGT 15 year asset exemption; the CGT 50 per cent active asset reduction; the CGT

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3 EM, p. 5.

4 EM, p. 4.

5 Schedule 1, item 1, subparagraph 328-110(1)(b)(i) of the ITAA 1997

6 EM, p. 11.

7 EM, p. 14.

retirement exemption; the CGT roll-over; simplified depreciation rules; simplified trading stock rules; immediate deduction for certain prepaid business expenses; choice to account for GST on a cash basis; annual apportionment of GST input tax credits; choice to pay GST by instalments; FBT car parking exemption; and PAYG instalments based on gross domestic product adjusted notional tax.[8]

Calculating 'aggregated turnover'

2.8 As paragraphs 2.3 and 2.4 noted, access to the STS and GST concessions is currently based on different definitions of 'turnover'. The bill, through the 'small business entity test', establishes a single definition and a procedure for calculating aggregated turnover.

2.9 The EM sets out three steps for performing this calculation. First, the turnover of an entity seeking to satisfy the small business entity test (the 'test entity') in an income year is the total ordinary income that the entity derives in that year in 'the ordinary course of carrying on a business'.[9] This is income that is regularly or customarily derived in the carrying on of a business, excluding salary and wages. The second step is to determine whether the test entity needs to aggregate its turnover with that of other entities. If other entities are affiliated or connected with the test entity, annual turnover needs to be aggregated.[10] Third, the aggregated turnover is the sum of relevant annual turnover, which includes that of the test entity and the turnover of any of its affiliates or connected entities.[11]

Schedule 3—Broadening eligibility for the simplified tax system

2.10 The STS is currently an optional system for small businesses with straightforward tax affairs to assess their taxable income. In the May 2006 federal budget, the Treasurer the Hon. Peter Costello, announced 'changes to make the Simplified Tax System more attractive'.[12] These changes are part of the amendments to the small business entity framework outlined in Schedule 1.

2.11 The bill gives small business entities flexible access to STS concessions. First, it increases the STS average turnover threshold from $1 million to $2 million, as per the 'small business entity test' (see paragraph 2.3). Second, it removes the current $3 million depreciating assets test from STS eligibility requirements. Third, the bill amends those rules and requirements that currently apply to STS taxpayers. Small business entities will not have to elect into STS to be eligible for STS concessions and

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8 See *Income Tax Assessment Act 1997*, Schedule 3, item 2, section 328-10.

9 EM, p. 20.

10 Subsection 995-1 of the ITAA 1997 gives definitions of 'affiliate' and 'connected with'.

11 EM, p. 32

12 The Hon. Peter Costello MP, Treasurer, 2006–07 Budget Speech, 9 May 2006, pp. 5–6. http://www.budget.gov.au/2006-07/speech/download/Budget_Speech.pdf (accessed 16 May 2007).

they can choose whether or not to apply special rules for deducting amounts for depreciating assets.[13] It will not be compulsory for small business entities to use particular concessions, as was the case under the STS.[14]

Schedules 2 and 4—Increasing small business concession thresholds

2.12 The bill relaxes some of the threshold tests for the GST and CGT small business concessions, and abolishes the need for small businesses to elect into the simplified tax system (STS) to access concessions. These measures give effect to the Treasurer's announcements in the May 2006 federal budget.[15] Their purpose is simply to increase the number of small businesses able to access the concessions.[16]

2.13 Currently, the *A New Tax System (Goods and Services Tax) Act 1999* requires that an entity seeking to claim a GST cash accounting concession must not have an annual turnover exceeding $1 million. Schedule 2 of the bill increases the GST cash accounting threshold from $1 million to $2 million.

2.14 Under Division 152 of the ITAA 1997, small business entities can access small business CGT concessions. Schedule 4 of the bill increases the net asset value test threshold for accessing the CGT small business concession from $5 million to $6 million. Small business entities—those that satisfy the small business entity test—and entities with a net asset value of less than $6 million will be able to access the CGT small business concessions.

Schedules 5 and 6—Fringe Benefits Tax and PAYG Instalments

2.15 The 2006 federal budget announced that STS taxpayers will have FBT car parking exemption. Schedule 5 of the bill extends this exemption to small business entities.

2.16 The budget also announced that full self assessment STS taxpayers will have access to PAYG instalments based on GDP adjusted notional tax. Schedule 6 of the bill increases the base assessment instalment income threshold $1 million to $2 million. Treasury explains that the purpose of this increase is due to the planned application of this measure from the 2009–10 income year. This date is 'due to ATO

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13 EM, p. 43.

14 EM, p. 42.

15 The Hon. Peter Costello MP, Treasurer, 2006–07 Budget Speech, 9 May 2006, pp. 5–6. http://www.budget.gov.au/2006-07/speech/download/Budget_Speech.pdf (accessed 16 May 2007).

16 Tax Laws Amendment (Small Business) Bill 2007, Aligning concessions for small business, p. 2.

systems limitations that make them unable to accommodate the changes in the short-term'.[17]

Schedule 7—Depreciating asset roll-over relief

2.17 Schedule 7 of the bill extends the roll-over relief available under the uniform capital allowance system to small business entities who make deductions for depreciating assets.[18] Under Subsection 328-D of the ITAA 1997, a small business can choose to deduct amounts for depreciating assets that are used for a taxable purpose. The EM explains that the depreciating assets with lives of 25 years or more must be placed into a long life small business pool with a five per cent depreciation rate; assets with lives of less than 25 years are allocated into a general small business pool with a depreciation rate of 30 per cent.

2.18 Division 40 of the ITAA 1997 sets the broader framework for asset depreciation, establishing a general set of rules for calculating the decline in an asset's value. Subsection 40-295(2) of the Act allows for an adjustment to a depreciating asset's value if there is a change in its holding, and if the asset was held by a partnership either before or as a result of the change. Subsection 40-D calculates the amount of the adjustment as the difference between the actual value of the asset at the time of the change in holding and the adjusted value. However, it is possible to defer this adjustment to assessable income until the actual disposal of the asset. There are two options: automatic roll-over relief (subsection 40-430(1)) or optional roll-over relief (subsection 40-340(3)).[19]

2.19 The EM notes two important changes to roll-over relief prior to the bill. The *Taxation Laws Amendment Act (No. 2) 2004* provided optional roll-over relief for depreciating assets in a simplified tax system (STS) pool, providing the entities both before and after the change were partnerships. The *Tax Laws Amendment (2004 Measures No. 7) Act 2005* relaxed this required, granting roll-over relief where the entity was a partnership *either* before or after the change in holding.

2.20 This bill extends optional asset roll-over relief under the uniform capital allowances regime to a sole trader, trustee or partnership disposing of all assets in a small business pool to a wholly owned company.[20] This relief will also be available for small business entities that dispose of all assets in the business pool to another taxpayer as a result of a marriage breakdown. As these changes only apply under

17 Tax Laws Amendment (Small Business) Bill 2007, Aligning concessions for small business p. 2.

18 The Hon. Mr Peter Dutton, Minister for Revenue, *House of Representatives Hansard*, 10 May 2007, p. 3.

19 EM, p. 36.

20 EM, p. 36.

Section 328-D of the ITAA 1997, the assets must be placed in either a general or long life small business pool).[21]

Treasury's consultation process

2.21 The committee received details from the Treasury on the public consultation process on the draft of the bill. There was an initial consultation period from 8 February through to 26 February 2007 during which copies of the exposure draft bill were emailed to industry representatives. On 12 February, Treasury convened a meeting with representatives from major accounting and taxation bodies, the ATO and an academic from the School of Taxation at the University of New South Wales. As a result of this process, Treasury received eleven submissions which unanimously supported the alignment of eligibility thresholds for small business concessions.

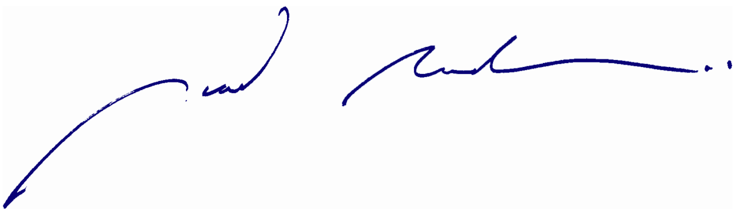
2.22 A second round of consultations was undertaken from 28 March to 5 April 2007. The parties involved in the first round were provided with a revised draft bill and an EM. Treasury received a further six submissions which raised five further issues. The Department did not expand on the nature of these, other than to confirm that the two of these five it chose not adopt 'would have expanded the scope of the small business framework beyond that which was considered appropriate'.[22]

Comment on the bill

2.23 The committee received a submission from the Small Business Development Corporation, an independent statutory authority established to assist the small business sector in Western Australia. The SBDC supported the bill noting that the single definition of small businesses is consistent with its recommendation to the Commonwealth Regulation Taskforce in November 2005. The Corporation argued in its submission that 'the proposed amendments will be beneficial overall to many small businesses', and that 'it is unlikely that any small businesses would be worse off under the proposed Bill as no additional compliance burden should be created'.[23]

Recommendation 1

2.24 The Committee recommends that the bill be passed.



Senator the Hon. Michael Ronaldson
Chair

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21 EM, p. 38.

22 Correspondence from Treasury, 'Consultation', dated 24 May 2007.

23 *Submission 1*, pp. 1–2.