

Our Ref: BMH:CDS:

5 July 2018

Board of Taxation Secretary
The Treasury - Melbourne Office
Level 6, 120 Collins Street
Melbourne VIC 3121

By Email: taxboard@treasury.gov.au

Dear Secretary

Small Business Tax Concessions

Cleary Hoare Solicitors welcomes the invitation to provide comment in relation to the Small Business Tax Concessions. We understand that the Board of Taxation is undertaking a review of the Small Business Tax Concessions to identify areas in which the concessions are less effective, or not well targeted, and could be redeveloped.

Cleary Hoare Solicitors are uniquely positioned to comment on these concessions as an advisor to private business clients throughout Australia and as a firm we provide advice on the application of the Small Business Tax Concessions to clients on a daily basis.

Small Business Tax Rate

1. In 2017, the *Treasury Laws Amendment (Enterprise Tax Plan) Act 2017* amended the *Income Tax Rates Act 1986* which changed the corporate rate of tax for small business entities from 28.5% to 27.5% from the 2016/17 financial year.
2. Prior to this legislation, it was possible for corporate small business entities to frank a dividend "as if" that company were still being taxed at the 30% rate. Obviously, this was contingent upon the company having sufficient franking credits to do so.
3. However, this new legislation changes that. The legislation changes the maximum franking credit that can be attached to a dividend. The maximum franking credit will now be worked out by reference to the company's corporate tax rate for prior income year.
4. In short, what these changes mean, is that some corporate small business entities will be unable to pass on all of the franking credits they generated while the company was a company taxed at the 30% rate. This will result in the company with excess or "trapped" franking credits.
5. We suggest that the legislation is amended to utilise the "trapped" franking credits and allow them to be offset against income.

Small Business CGT Concessions

6. In 2017, the aggregated turnover threshold for small business entities was increased from \$2 million to \$10 million. However, the \$10 million turnover does not apply to Small Business CGT Concessions, which continue to have a \$2 million turnover threshold.
7. We submit that having the Small Business CGT Concession turnover threshold remain at \$2 million is too low.
8. We urge you to consider amending the legislation so that the \$10 million aggregated turnover test in relation to the small business tax rate also applies to Small Business CGT Concessions.

Trapped Losses

9. With corporate small business entities any losses that the company makes are quarantined or "trapped" in the company. We suggest that the legislation is amended so that tax losses are not "trapped" in the company and can flow to shareholders of that company.
10. This provide more incentive to start-up businesses, considering many of these businesses operate in a loss position to begin with. Those losses are usually met by the shareholders contributing more funds, if they were able to offset the losses that would provide more incentive for the shareholders to start-up businesses and contribute more funds.
11. This change could be accomplished by applying these measures to companies that meet the small business turnover tests.

Changes to Small Business CGT Concessions

12. An Exposure Draft was released for public comment on 8 February 2018 and seeks to amend Division 152 of the *Income Tax Assessment Act 1997*. There were a few changes made to the exposure draft prior to the *Treasury Laws Amendment (Tax Integrity and Other Measures) Bill 2018* which was introduced into parliament on 28 March 2018 and passed by the House of Representatives on 10 May 2018.
13. The amendments (additional basic conditions) only apply to capital gains relating to CGT assets that are a share in a company or interest in a trust (referred to as "the Object Entity"). Broadly, the amendments relate to the asset, the taxpayer and the Object Entity.
14. It is our view that the amendments are significantly more wide-reaching than the original intentions of the budget announcement and lead to inequity in certain circumstances.

Unnecessary tests

15. The amendments will require a taxpayer to apply the tests contained in sections 152 - 30(3) and 152-10(2A). However, there will be no circumstance where the test contained in section 152 - 30(3) will apply and the test in section 152-10(2A) does not apply.

16. We submit that it is unnecessary to have both tests and would be simpler if the only test was as contained in section 152 - 30(3).

Connected entities from 40% to 20%

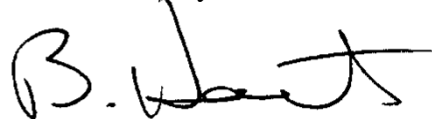
17. In essence, a taxpayer will now be assessed on the turnover and maximum net asset value test twice under these provisions, once at the taxpayer level and once at the Object Entity level.
18. However the inclusion of affiliates and the lowering of the threshold for connected entities in the draft legislation from 40% to 20% for the tests at the Object Entity level will lead to the inclusion of assets or turnover that will not normally have been considered when evaluating the taxpayers position, which will lead to an unfair result on some taxpayers.
19. There will be situations under the new condition due to the reduced tests for a "connected entity" where clients who would normally have access to the concessions (and for whom they are meant to operate) will be excluded from accessing them due to this second test on the object entity.
20. There will also be situations where taxpayers in some structures will be advantaged over taxpayers to which these provisions apply as they will not have to apply the tests twice in order to obtain the concessions.

Summary

21. In summary, we suggest the following changes:
- 21.1 Allow the excess franking credits that have been "trapped" in the corporate small business entities to be offset against income;
 - 21.2 That the \$2 million aggregated turnover threshold that applies to Small Business CGT Concessions is increased to \$10 million; and
 - 21.3 Allow tax losses that are "trapped" in the corporate small business entities to flow to shareholders of the corporate small business entities.

Thank you for the opportunity to provide these comments and we are happy to be involved in any further consultation. If you require any further clarification on the issues raised and our views on them, please do not hesitate to contact the writer or Catherine Da Silva of our office.

Yours faithfully



Brett Hart

Cleary Hoare Solicitors