

2017-18 Pre-Budget Submission

January 2017



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CEO'S Foreword

Tax and Super Australia, formerly known as Taxpayers Australia Limited welcomes the opportunity to lodge a pre-Budget submission to the Government for consideration in the preparation of its 2017-18 Federal Budget.

Tax and Super Australia is a not-for-profit organisation committed to a fairer and more transparent taxation system for every Australian taxpayer. Our aim is to provide taxation practitioners, superannuation professionals, small businesses and individuals with up-to-date, informative and above all understandable information about Australian taxation.

As a community benefit organisation, we are independent and unaffiliated with any political or commercial groups, advertising or sponsoring organisations. We are a member-based organisation, and our loyalty is dedicated to our members.

Most of our members are small to medium sized tax agents. Small business taxpayers and individual taxpayers are the key client groups for these tax agents.

Small business operators and individuals who manage their own tax affairs represent the other major groups in our membership base.

Given our membership demographics, we focus our tax advocacy activities (including submissions to Government) on legislative and administrative matters that are relevant to individual and small business taxpayers. Our priorities in this regard are reflected in this 2017-18 pre-Budget submission.

Our pre-Budget submission recommendations have been driven by the priorities, concerns and ideas of our members. We receive this information directly from our members through various channels. These channels include our helpline service, member surveys, training activities and discussion groups. In addition, in May 2015 we conducted a member survey that covered a broad range of taxation and superannuation issues. Our suggestions also reflect our overarching objective of achieving a suitable balance of fairness, efficiency and simplicity in the taxation system.

If you would like to discuss any of our recommendations further, please contact Mr Andy Nguyen, Tax Technical Services Manager (email: anguyen@taxandsuperaustralia.com.au; phone: 03 8851 4555).



Moti Kshirsagar

Chief Executive Officer

Tax and Super Australia

Summary of recommendations

Recommendation	Key points	Page
A. Individuals taxation		
<p>Recommendation A.1:</p> <p>That the Government introduces a tax offset for mature age workers that:</p> <ul style="list-style-type: none"> ■ reduces the effective tax rate applying to employment income ■ is uncapped ■ is refundable; and ■ is simple to understand and apply. 	<ul style="list-style-type: none"> ■ Increasing the mature age workforce will reduce reliance on public spending ■ The former mature age worker tax offset was ineffective but the concept remains popular ■ The proposed offset should provide sufficient incentive for the taxpayer to remain in employment ■ The Government needs to consider employer incentives to hire older workers, in conjunction with tax incentives for employees 	8
<p>Recommendation A.2:</p> <p>That the Government increases the standard work-related expense deductions, which are exempt from substantiation rules, to \$2,000.</p>	<ul style="list-style-type: none"> ■ Work-related expenses are the most significant deduction category for individuals ■ Work-related expense deductions are a key source of the compliance burden ■ Easing the compliance burden needs to be a Government priority ■ A higher statutory deduction should ease the burden of many employee taxpayers ■ The ATO can redirect its scarce resources away from low scale deductions 	11
<p>Recommendation A.3:</p> <p>That interest income derived from bank deposits and other passive investments should be concessionaly taxed.</p>	<ul style="list-style-type: none"> ■ The Government needs to encourage personal savings to reduce the future reliance of an ageing population on public funding ■ Interest income from cash investments should be concessionaly taxed ■ A tax concession on cash investments will particularly incentivise lower income individuals and households to save ■ Returns on other forms of investment currently attract concessional taxation treatment ■ Interest income should be exempt up to a statutory cap, for simplicity of administration 	15

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B. Small business taxation		
<p>Recommendation B.1:</p> <p>That the Government retains \$20,000 as the permanent threshold for the small business instant asset write-off.</p>	<ul style="list-style-type: none"> ■ Small businesses consider administrative requirements a costly burden and appreciate relief mechanisms ■ The instant asset write-off eases small business compliance burdens ■ A constantly changing threshold causes uncertainty and confusion ■ A permanent threshold of \$20,000 will help many small businesses ■ Maintaining a \$20,000 threshold is unlikely to put public revenues at risk over the longer term 	17
<p>Recommendation B.2:</p> <p>That the Government increases the threshold for the small business CGT concessions and the small business tax offset to \$10 million.</p>	<ul style="list-style-type: none"> ■ The 2016-17 increase in the threshold for most small business concessions to \$10m is commendable ■ Three small business concession thresholds will cause confusion and extra compliance burden ■ The thresholds for the small business income tax offset and the CGT concessions should be raised to \$10m 	22
<p>Recommendation B.3:</p> <p>That the Government reintroduces the loss carry-back tax offset for companies that are small business entities.</p>	<ul style="list-style-type: none"> ■ The former loss carry-back tax offset should be reinstated for small companies ■ The repeal of the former offset was not because it was flawed ■ Small businesses will benefit from the offset 	24
C. Superannuation		
<p>Recommendation C.1:</p> <p>That the Government expands the myGov superannuation dashboard to provide online tools to assist taxpayers in complying with the newly legislated superannuation rules.</p>	<ul style="list-style-type: none"> ■ New superannuation rules require affected taxpayers to regularly keep track of balances, transactions and thresholds ■ Online tools can help taxpayers and their advisers reduce the compliance burden ■ Online tools that can automatically provide account and transaction information can be made available as part of the existing suite of superannuation services on myGov 	27

Recommendation	Key points	Page
<p>Recommendation C.2.1:</p> <p>That the Government amends s307-80(4) of the ITAA97. Penalties for a failure by the superannuation income stream provider to comply with the commutation authority should be directed to the provider and not the superannuant.</p>	<ul style="list-style-type: none"> ■ New s307-80 requires a superannuation income stream provider to comply with a commutation authority ■ However, the penalty for non-compliance is levied on the superannuant ■ The penalty should instead be directed to the superannuation income stream provider 	29
<p>Recommendation C.2.2:</p> <p>That the Government provides an alternative to the court system for establishing that a superannuation interest is reduced because of a loss suffered by the superannuation income stream provider as a result of fraud or dishonesty</p>	<ul style="list-style-type: none"> ■ A debit is made to a taxpayer’s transfer balance account if a loss to the superannuation interest is due to fraud or dishonesty ■ However, a court conviction for fraud or dishonesty is required for the taxpayer to obtain the debit ■ Court proceedings are very costly and time-consuming ■ There needs to be an alternative mechanism, such as empowering tribunals or ATO and APRA to decide that fraud or dishonesty occurred, or empowering the relevant Minister to make a determination that fraud or dishonesty occurred 	30
<p>Recommendation C.2.3:</p> <p>That the Government amends the law so that insurance proceeds received due to temporary or permanent incapacity or a terminal medical condition is given the same treatment as structured settlement proceeds</p>	<ul style="list-style-type: none"> ■ The new superannuation law allows structured settlement proceeds to be excluded from calculations of certain balances ■ Consequently, a receipt of structured settlement proceeds does not have a negative impact ■ Insurance proceeds received due to temporary or permanent incapacity or a terminal medical condition should be treated in the same manner 	30
<p>D. Other key issues</p>		
<p>The Government should dedicate funding to bring about the necessary comprehensive legislative change for priority issues.</p>	<ul style="list-style-type: none"> ■ The taxation of trusts ■ Review of the personal services income rules ■ Better targeting of the CGT discount ■ Commitment to long term tax reform ■ Improving whole-of-government use of technology 	32

Glossary

The following references, acronyms and abbreviations have been used in this submission:

Legislation	
<i>Income Tax Assessment Act 1997</i>	ITAA97
<i>Income Tax Assessment Act 1936</i>	ITAA36
Key reports	
Commonwealth of Australia, <i>Australia's Future Tax System: Report to the Treasurer</i> (December 2009)	<i>Australia's Future Tax System</i>
Australian Government, <i>2015 Intergenerational Report: Australia in 2055</i> (March 2015)	<i>Intergenerational Report</i>
Board of Taxation, <i>Review of Tax Impediments facing Small Business</i> (August 2014)	<i>Review of Tax Impediments facing Small Business</i>
Other terminology	
Australian Taxation Office	ATO
Board of Taxation	the Board
Tax and Super Australia	TSA
Member survey conducted by TSA in May 2015 (relating to a range of taxation and superannuation issues)	our survey
Minerals Resource Rent Tax	MRRT

Part A: Individuals taxation

A.1 Tax offset for mature age workers

Recommendation A.1: That the Government introduces a tax offset for mature age workers that:

- reduces the effective tax rate applying to employment income
- is uncapped
- is refundable; and
- is simple to understand and apply.

Increasing the mature age workforce will reduce reliance on public spending

According to the *Intergenerational Report*, the next 40 or so years will see an ageing population, attended by a decreasing proportion of the working age population. Population projections for 2054-55 include the following:¹

- increased life expectancy: 95.1 years for men and 96.6 years for women (91.5 years and 93.6 years respectively at the time of the report)
- the number of people aged 65 and over will more than double; and
- 1 in 1,000 people will be aged over 100.

As a result, there will be fewer people of working age compared with the very young and the elderly. There are currently 4.5 people aged 15-64 for every person aged 65 and this will nearly halve to 2.7 by 2054-55.

The *Intergenerational Report* also notes that public spending is highest for the over-65 age group. The key drivers relevantly include decreased participation in the workforce and increased demand for government services and payments such as the Age Pension and aged care.²

Given the projected future demographic of Australia, the Government must put in place incentives for mature age Australians to continue workforce participation. Increasing labour income for these individuals will reduce net public spending on the Age Pension and age-related transfers and benefits. Further, labour income that is excessive to consumption needs will be available for personal savings and investments, leading to a greater capacity for an individual to self-fund their eventual retirement.

The former mature age worker tax offset was ineffective but the concept remains popular

The former mature age worker tax offset (MAWTO) was introduced in 2004-05 but abolished from 1 July 2014. The Government's rationale for abolishing the offset included the following flaws:³

- the MAWTO was complicated and not well understood (for example, it necessitated the calculation of multiple elements – including amounts that were not taxable; and it applied using a progressive “tax bracket” system)

¹ *Intergenerational Report*, p1.

² *Intergenerational Report*, p58.

³ The Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2014 Measures No. 5) Bill 2014*.

- it was not a cost effective way of encouraging mature age workforce participation
- the \$500 maximum value itself wasn't generally a sufficient incentive.

Even though the MAWTO has been repealed due to its ineffectiveness, our members still support the concept of offering tax incentives for older workers. In fact, only 24% of our survey's respondents disagreed with the principle of using concessional tax rates to encouraging mature age workforce participation.

The Government should reintroduce the worthy concept of a mature age worker tax offset – one without the flaws of the former MAWTO. Such a tax incentive for workers would complement non-tax Government initiatives aimed at employers, such as the *Restart* programme.

How should the proposed tax offset work?

The Government should introduce a tax offset for mature age workers with the following characteristics:

- it reduces the effective tax rate applying to employment income (to provide sufficient incentive for the taxpayer to remain in employment)
- it is uncapped (so that taxpayers are not discouraged from earning more labour income)
- it is refundable (so that it genuinely results in a reduction to the effective tax rate on employment income and the tax benefit is not compromised by unrelated tax matters); and
- it is simple to understand and apply (so that taxpayers can easily see the benefit gained from working and are not deterred from actively seeking to access the offset).

The proposed tax concession will encourage mature age individuals to re-enter or remain in the workforce – but they can only do so if employers are willing to hire them.

The Government is commendably addressing this issue outside of the taxation arena. The *Restart* programme provides wage subsidies to employers of older workers. Under the *Corporate Champions* programme, large employers that commit to best practice in employing older people can access publicly funded assistance from industry experts.

It is critical that the Government builds on these existing efforts to encourage employers to hire older workers. We therefore urge the Government to allocate resources, in the 2017-18 Budget, to creating more incentives and support mechanisms for employers to recruit, train and retain older workers. Tax incentives for older workers will then supplement and support these employer-focused programmes to keep mature age individuals in the workforce.

A.2 Standard work-related expense deduction

Recommendation A.2: That the Government increases the standard work-related expense deductions, which are exempt from substantiation rules, to \$2,000.

Work-related expenses are the most significant deduction category for individuals

Australia's Future Tax System reports that work-related expenses are the most commonly claimed deductions for employees – and that claims have been growing substantially over recent years.⁴ ATO statistics support these claims. Stated as a proportion of total deductions (by dollar value), work-related expenses rose from 49% in 2005-06,⁵ to 56% in 2009-10,⁶ to 62% in 2013-14.⁷

The ATO data also shows that in 2013-14, nearly 8.6 million taxpayers (around two-thirds of all individual taxpayers) claimed work-related expenses to the value of \$20,782,318,726.⁸ This equates to an average deduction of **\$2,417** per claimant.

Work-related expense deductions are a key source of the compliance burden

Australia's Future Tax System reports that in 2007-08, 86% of individual taxpayers either claimed no deductions at all or only claimed work-related expenses, gifts and the cost of managing tax affairs.⁹ Yet, 72% sought advice from a tax agent.¹⁰ In that year, the value of total work-related expense deductions comprised 48% of total deductions for individuals.¹¹

In 2013-14, based on the ATO's data, 74% of individual tax returns were lodged through a tax agent.¹² The dollar value of all work-related expense deductions in that year (\$20.8 billion) was 62% of the value of all deductions taken by individual taxpayers.¹³

Over the past decade, a majority of taxpayers have sought professional advice in completing their tax returns – and the vast majority of the expenses that they are claiming are work-related. It is clear that the deductibility of work-related expenses is a key driver for taxpayers to seek professional advice.

The current compliance, substantiation and record keeping burdens impose enormous financial and time costs for both taxpayers and tax practitioners.

Work-related expense deductions are usually taken under the general deduction provision in s8-1 of the ITAA97. There are few prescriptive legislative rules governing work-related expense deductions, with the exception of a few specific types of expenditures (eg. car expenses and self-education expenses). Most judicial and ATO guidance available to taxpayers is principles based and extremely fact-specific.

Accordingly, ascertaining whether an expense is deductible in nature and quantifying the deductible amount (including any necessary apportionment between work and private use) are tasks which are complex, time-consuming and loaded with uncertainty.

Stringent statutory substantiation rules¹⁴ add to the compliance burden.

4 Chapter 4.1 of *Australia's Future Tax System*.

5 ATO, Table 7 of *Taxation Statistics 2009-10*.

6 ATO, Table 7 of *Taxation Statistics 2009-10*.

7 ATO, Table 1 of *Taxation Statistics 2013-14*.

8 ATO, Table 1 of *Taxation Statistics 2013-14*.

9 Chapter 4.1 of *Australia's Future Tax System*.

10 Chapter 4.1 of *Australia's Future Tax System*.

11 ATO, Table 7 of *Taxation Statistics 2009-10*.

12 ATO, Table 1 of *Taxation Statistics 2013-14*.

13 ATO, Table 1 of *Taxation Statistics 2013-14*.

14 The work expenses substantiation rules are contained in Subdivision 900-B of the ITAA97.

Easing the compliance burden needs to be a Government priority

In our survey, 63% of respondents indicated that improvements to the work-related expense deduction system are necessary. Specifically, 26% wanted a standard deduction to *reduce compliance burdens*. It appears that practitioners are frustrated with the inherent uncertainty and voluminous administrative burden involved in determining and substantiating claims.

The legislation currently provides limited relief from the compliance burden by providing an exemption from the substantiation rules where the total of work expenses claimed does not exceed \$150 of laundry expenses¹⁵ or \$300 of total work-related expenses (including laundry expenses).¹⁶

While this legislated relief is appreciated, in practice the low thresholds do not assist the majority of taxpayers who incur work-related expenses, as evidenced by the data cited above: ie. that the average claim exceeds \$2,000 and the majority of claimants still need professional assistance.

A higher statutory deduction should ease the burden of many salary and wage earners

The statutory cap for work-related expense deductions that can be claimed without substantiation should be increased from its current \$300 to \$2,000. As cited above, the mean average work-related expense deduction for 2013-14 was \$2,417. Therefore, a cap of \$2,000 would enable most of Australia's "average" employee taxpayers to claim their legitimate deductions without the substantiation burden.

Where the claim exceeds \$2,000, the entire claim (including the first \$2,000) should be subject to the substantiation rules to prevent high value improper claims.

The ATO can redirect its scarce resources away from low scale deductions

Driven by the volume and proportional significance of work-related claims, the ATO has clearly been focusing on these deductions in its compliance activities in recent years. The most recent years have seen the ATO take a much wider approach than in the past. In 2013 the ATO trialled a pilot in which expected deduction amounts were derived from an analysis of comparable taxpayers.¹⁷ For 2014-15, the ATO focused on "unusually high" work-related expense claims across all industries and occupations.¹⁸ Currently, the ATO is scrutinising claims that are "higher than expected" for 2015-16 and has warned taxpayers that better technology and extensive use of data have expanded the ATO's ability to check these claims.¹⁹

The scale and substance of the ATO's compliance approach to work-related expense deductions demonstrate the ATO's concern over these claims.

In 2014, the ATO contacted 2,000 taxpayers in relation to their 2012-13 claims. As of November 2014, the 2013-14 work-related claims for 1,167 of those taxpayers had collectively decreased by **\$10 million**.²⁰ On average, each of those taxpayers had significantly reduced their deduction by **\$8,569**. Clearly there is a need for the ATO to conduct educational and compliance activities for taxpayers with deductions that are significantly larger than average.

Raising the statutory deduction threshold to \$2,000 will enable the ATO to devote more of its limited financial and human resources to compliance activities relating to high value deductions.

¹⁵ Section 900-40 of the ITAA97.

¹⁶ Section 900-35 of the ITAA97.

¹⁷ Item 9 of the ATPAG minutes, November 2014.

¹⁸ Media release dated 27 May 2015.

¹⁹ Media release dated 24 October 2016.

²⁰ Item 9 of the ATPAG minutes, November 2014.

A.3 Concessional taxation of interest income

Recommendation A.3: That interest income derived from bank deposits and other passive investments should be concessionally taxed.

The Government needs to encourage personal savings

The *Intergenerational Report* projects that the next 40 years will see an ageing population and a decreasing proportion of the population that are of working age. It is expected that by 2054-55, there will be only 2.7 aged 15-64 for every person aged 65 (currently there are 4.5). See the commentary in section A.1 for more detail.

To ensure that Australia can maintain its standard of living in those future years during which there will be proportionally fewer working taxpayers to fund Commonwealth welfare and transfer programs, TSA recommends that the Government implements initiatives to encourage personal savings (in addition to superannuation) to reduce future reliance on the publicly funded transfer and welfare systems.

Specifically, we recommend that interest income derived from deposits held at financial institutions, bonds and other cash investments should be concessionally taxed, to increase household savings.

A tax concession will particularly incentivise lower income individuals and households to save as cash investments are often low risk, liquid, simple to administer and require minimal capital outlay. For taxpayers with higher levels of disposable income, interest-bearing investments will become a more attractive and competitive savings vehicle relative to other forms of investment, many of which currently attract favourable taxation treatment.²¹

ATO data shows that in each year from 2010-11 to 2013-14, between 7.1 million and 7.5 million taxpayers derived assessable interest income²² - ie. over half of the approximately 13 million individual taxpayers that lodged tax returns that year. A tax concession on interest income would benefit a majority of Australian individuals and households from immediate tax savings as well as encourage them to save for retirement.

A capped tax exemption

We recommend that the Government implements an exemption for interest income derived by an individual up to a statutory cap per taxpayer per year. Any interest income exceeding the cap would be taxed at the individual's marginal tax rate.

Taxpayers can simply exclude their interest income, up to the cap amount, from their assessable income. Individuals deriving lower than the cap amount would not need to include any interest income. This is the simplest method of offering a tax concession as there would be no need to calculate discounted assessable amounts (as is required with various CGT concessions) or to apply specific tax rates.

The existing pre-fill and data matching arrangements that the ATO has with financial institutions would make it easy for taxpayers to comply and for the ATO to conduct integrity checks.

The exemption cap should be adjusted to an economic indicator (eg. CPI) periodically (eg. every 2 or 3 years) as interest rates on passive cash investments broadly move in line with adjustments to the Reserve Bank's official government interest rate. The cap should also only be available in respect of Australian source interest income to encourage taxpayers to keep their investments in Australia, for the benefit of the Australian economy.

²¹ For example, franked dividends provide imputation credits which in many cases reduce the tax rate on the dividends to below the taxpayer's marginal tax rate, and CGT assets held for longer than 12 months attract a 50% discount on the net capital gain.

²² ATO, Table 1 of *Taxation Statistics 2013-14*.

Part B: Small business taxation

B.1 The instant asset write-off threshold

Recommendation B.1: That the Government retains \$20,000 as the permanent threshold for the small business instant asset write-off.

Administrative obligations are a costly burden for small business

From our constant interaction with our members, we know that record-keeping is a costly burden for small businesses – and their advisers. For example, in our survey, 63% of respondents reported that administrative obligations were the most significant driver of tax compliance costs for small business. Further, the simplification of administrative requirements was the most popular option for improving small business taxation (with 40% nominating this as their preferred improvement).

A small business often expends a lot of time, labour and costs on external advisers just to claim a capital allowance deduction to which it is entitled under the ITAA97. We receive many questions in relation to the detailed mechanics of the tax depreciation rules. Our members also show a lot of interest in the small business depreciation concessions. Small businesses appreciate the administrative relief that those concessions offer and they are keen to use them. However, small business operators still find the concessions to be complicated and require clarification and assistance.

The Government can simplify the depreciation concessions further and provide permanent, ongoing compliance relief to small businesses by retaining the current \$20,000 threshold for the instant asset write-off as the permanent threshold.

The instant asset write-off eases small business compliance burdens

Small businesses benefit from the instant asset write-off in two broad ways:

- relief from the burden of maintaining depreciation records over a long period of time for such low cost assets; and
- upfront tax benefit arising from the immediate deduction of the full cost of the asset.

The instant asset write-off is commonly used within our membership base. Each year we receive many queries about the mechanics of the concession. In fact, the temporary increase of the instant asset write-off threshold to \$20,000 was the 2015-16 Budget announcement that generated the most queries and interest from our members.

However, in recent years, multiple changes to the “low cost” threshold have unfortunately negated some of the administrative benefits offered by the write-off.

A constantly changing threshold causes uncertainty and confusion

Up to 2012-13, the threshold was \$1,000. Then, for a mere 18 months – from 1 July 2012 to 31 December 2013 – the threshold was increased to \$6,500.

For a further period of less than 18 months – 1 January 2014 to 12 May 2015 – the threshold reverted to \$1,000.

The most recent change to the threshold was a significant and generous increase to \$20,000, from 7.30pm (AEST) on 12 May 2015. This threshold will once again be \$1,000 on 1 July 2017.

There was also a temporary concession which allowed small businesses to write off the first \$5,000 on a motor vehicle costing at least \$6,500 (with the remaining cost amount depreciated over the effect life of the vehicle). This concession applied for 2012-13 and 2013-14 – it existed in conjunction with the \$6,500 instant asset write-off for all depreciating asset categories. From our member feedback over the years, the multiple and differing write-offs offered led to confusion and resources dedicated to understanding them.

The efforts of successive governments to retain the concession in order to simplify compliance obligations and reduce administrative costs for small business is appreciated. However, the frequent changes to the threshold over the past 4 years, as well as the additional and temporary motor vehicle write-off, have caused confusion and uncertainty amongst the small business and tax professional communities.

Administrative costs are unnecessarily increased as users of the concession dedicate human and financial resources to understanding the changes, ensuring that their low cost purchases meet the timing and cost rules and adjusting their financial and business plans accordingly.

A permanent threshold of \$20,000 will help many small businesses

The threshold is legislated to reduce to \$1,000 on 1 July 2017 – this means that the \$20,000 threshold will be in place for less than 26 months.

Treasury data released in mid-December 2015, which was publicly reported in the mass media,²³ relating to small business tax returns lodged in the period from 1 July to 15 December 2015 (in respect of the 2014-15 financial year), shows the extent to which the increased threshold had benefitted small businesses:

- 99,335 small businesses claimed a total of \$418.5 million.²⁴ By comparison, 77,951 small businesses claimed a total of \$250.3 million in the same period in the previous year (when the threshold was \$1,000).²⁵
 - This equates to a net increase of about 21,000 small businesses. According to Treasury figures, there were about 56,000 new claimants.²⁶
 - This also equates to a total increase in instant asset write-offs of over \$168 million claimed by the small business community.
- The average claim was \$4,213, compared with \$3,211 the previous year.²⁷

This data indicates that upon its implementation, the \$20,000 threshold was achieving its desired effect of encouraging small businesses to invest in necessary capital items by alleviating the cash flow burden that usually accompanies a long effective life of a costly asset.

Many small businesses had until May 2016 to lodge their 2014-15 tax returns. Therefore the final figures in relation to 2014-15 would show an even larger uptake of the instant write-off than the above data suggests.

The Government's oft-stated commitment to assisting small businesses is commendable. In line with this objective, the Government should amend the law so that \$20,000 becomes the permanent threshold. This threshold is having a real effect in the small business community, in both encouraging investment in productive assets and reducing compliance burdens.

The Government's own Minister for Small Business, Michael McCormack, is reportedly advocating for an extension of the \$20,000 write-off.²⁸ We urge the Government to consider our submission which is consistent with the Minister's advice for helping the small business community.

23 For example, see:

Mather, Joanna: *Tax break taken up by 99k small businesses*, Australian Financial Review, 23 December 2015.

Waters, Cara: *Small business cashes in on \$20,000 tax break*, The Sydney Morning Herald, 15 December 2015.

24 Waters, Cara: *Small business cashes in on \$20,000 tax break*, The Sydney Morning Herald, 15 December 2015.

25 Waters, Cara: *Small business cashes in on \$20,000 tax break*, The Sydney Morning Herald, 15 December 2015.

26 Waters, Cara: *Small business cashes in on \$20,000 tax break*, The Sydney Morning Herald, 15 December 2015.

27 Waters, Cara: *Small business cashes in on \$20,000 tax break*, The Sydney Morning Herald, 15 December 2015.

28 Puvanenthiran, Bhakthi: *Budget 2017: Michael McCormack urges Treasurer to extend \$20,000 asset writeoff*, The Sydney Morning Herald, 10 January 2017.

The \$20,000 threshold should also be maintained for the small business pool

Under the temporary \$20,000 threshold rules, taxpayers are also currently able to deduct the entire balance of their general small business pool if that amount is less than \$20,000 for an income year. Under current law, this threshold will revert to \$1,000 on 1 July 2017.

The pool deduction threshold is the same as the instant write-off threshold. Therefore the movements in this threshold have been equally rapid and varied. Our recommendation to permanently maintain the \$20,000 instant write-off threshold also extends to permanently retaining \$20,000 as the threshold for writing off low pool balances.

Maintaining a \$20,000 threshold for these related depreciation rules will mitigate the uncertainty and confusion that the small business community currently experiences.

Maintaining a \$20,000 threshold is unlikely to put public revenues at risk

Maintaining the \$20,000 threshold permanently should have a negligible effect on total Government revenues over time. Any reduction in tax payable in the year that a business claims the write-off is compensated for in subsequent years for which it will not claim depreciation on that asset.

The Government increased the threshold to \$20,000 (albeit temporarily) in order to encourage businesses to invest in income-producing assets, where they otherwise may have delayed or never made that investment. Therefore it is reasonable to anticipate that a permanent \$20,000 threshold will result in increased tax revenues for the Government over time from income that may otherwise have never been derived.

These additional tax revenues should far offset any lost revenues from immediate tax deductions including any timing losses incurred as a result of the time value of money. Although a high threshold prima facie encourages illegitimate claims, the Government itself has mitigated the risk by introducing various integrity measures alongside the increase to \$20,000. The general anti-avoidance rule in Part IVA of the ITAA36 also exists as a deterrent. Finally, the Explanatory Memorandum to the amending legislation clearly states that the Government is willing to consider further legislative action if other integrity measures fail.

A permanent \$20,000 threshold will encourage small businesses to invest in income-generating assets by reducing costs of acquisition and administration, without any substantial risk or decrease to government revenues over time.

B.2 Harmonising the small business entity threshold

Recommendation B.2: That the Government increases the threshold for the small business CGT concessions and the small business tax offset to \$10 million.

The \$10 million threshold for most concessions is commendable

The Government's announcement in the 2016-17 Federal Budget that the previous \$2 million small business entity concessions threshold would be increased to \$10 million from 2016-17 for all concessions except the small business income tax offset and the small business CGT concessions was much appreciated. The threshold uplift will now enable many more businesses with turnovers between \$2 million and \$10 million to access a broad range of concessions.

Three different thresholds adds confusion and compliance burden

The flaw with the otherwise commendable initiative to raise the threshold to \$10 million is that it will not apply to two key concessions. The threshold for the tax offset for unincorporated small businesses has been increased to only \$5 million. The threshold for the CGT concessions remains at \$2 million.

The small business tax concession regime now has three tiers. Many businesses with annual turnovers from around \$2 million to around \$10 million will now have to separately apply eligibility tests for the different concessions. Some will be eligible for some concessions and not for others. This will cause confusion and increase the time and costs necessary for businesses to obtain advice and ensure that they claim concessions correctly.

A small business taxation regime that is intended to alleviate tax compliance burdens should be simple to understand and apply. This includes minimal variance in eligibility thresholds between the different concessions.

All small business turnover thresholds should be harmonised at \$10m

We recommend that the thresholds for all small business taxation concessions should be harmonised at \$10 million. For the 2017-18 Budget, this means raising the threshold for the small business tax offset and the small business CGT concessions.

The Government clearly considers that \$10 million is an appropriate turnover threshold for the majority of small business concessions. Therefore the \$10 million threshold should also be appropriate for the small business tax offset and the CGT concessions. Specific concessions already have different eligibility criteria in order to target particular activities, business types or transactions. There is no need to also set varying turnover limits.

B.3 Loss carry-back tax offset for small companies

Recommendation B.3: That the Government reintroduces the loss carry-back tax offset for companies that are small business entities.

The former loss carry-back tax offset should be reinstated for small companies

The Government should reintroduce the loss carry-back tax offset for companies that are small business entities.

The former offset was effective for only one year, 2012-13. Companies could choose to carry up to \$1 million of tax losses back to an eligible earlier year to obtain a tax offset for 2012-13, instead of carrying them forward.

The repeal of the former offset was not because it was flawed

The Government's repeal of the loss carry-back offset was not due to any ineffectiveness or failures of the measure. Rather, the offset was introduced as part of the MRRT package of tax measures – and consequently the offset was repealed solely because the MRRT was repealed.²⁹

The merits of the loss carry-back offset (discussed below) warrant its reintroduction now.

The MRRT package also included an increase in the instant asset write-off from \$1,000 to \$6,500. The increase was repealed at the same time as the loss carry-back. Yet, the Government has introduced another increase to the write-off threshold to \$20,000. This shows that the Government is willing to reverse an MRRT-related repeal – and, in fact, make the measure more generous – if it sees the merit in doing so.

Convincing arguments for having a loss carry-back tax offset are outlined in the Explanatory Memorandum to the legislation that introduced the original offset.³⁰ These include the following:

Encouraging companies to take opportunities

Loss carry-back will encourage companies to adapt to changing economic conditions and take advantage of new opportunities through investment. Firms will be able to utilise their tax losses sooner and reduce the extent to which they risk never being able to use those losses.³¹

Reducing asymmetrical treatment between profits and losses

Without a carry-back mechanism, there is an asymmetric treatment of company profits and losses. This is because the Commonwealth collects, as a tax, a share of profits that the company makes in an income year but does not share directly in a company's loss. Instead, future tax may be reduced if the company deducts a carried forward loss.³²

Reducing bias against risky investments

The asymmetry means that a company that makes a profit in one year and a loss in the next year will pay a higher effective tax rate over those two years than another company that makes the same total profit more evenly over the two years.³³ This can give rise to a bias against riskier investments, which diverts capital to investments that are of lower value for the economy.³⁴

29 Explanatory Memorandum to the *Minerals Resource Rent Tax Repeal and Other Measures Bill 2014*, 2.4.

30 The *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*.

31 Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*, 5.9.

32 Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*, 5.12.

33 Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*, 5.13.

34 Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*, 5.15.

Improving cash flow

A loss carry-back offset improves the cash flow of affected companies by allowing them to access their losses in a timelier manner. This promotes sensible risk taking by companies, helping them to adjust to changing economic conditions.³⁵

Small businesses will benefit from the offset

The offset should be reintroduced for companies that are eligible small business entities.

This would complement the various small business measures that the Government has introduced over the past few years. It would provide a cash flow benefit and encourage the company to take opportunities. It will also encourage investors to devote capital to these companies.

The former offset was only available if the company had paid tax in the previous two years. According to the Explanatory Memorandum introducing the original offset, this was to ensure that the offset was targeted to companies with a history of conducting a profitable enterprise and that the offset was not to be used for seed funding.³⁶

It would be appropriate to impose such a restriction on the reintroduced offset. This would ensure that the offset rewards previous success and encourage continuation of such success. The offset should not reward careless risk taking by management, which should not be done at public expense.

³⁵ Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*, 5.18.

³⁶ Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2013 Measures No. 1) Bill 2013*, 5.19.

Part C: Superannuation

C.1 Superannuation online tools

Recommendation C.1: That the Government expands the myGov superannuation dashboard to provide online tools to assist taxpayers in complying with the newly legislated superannuation rules.

Online tools will help taxpayers to comply with new superannuation rules

The recent superannuation reforms have established a new framework that takes effect on 1 July 2017. The reception of the changes has been mixed partly due to the perceived complexity of the new rules, as evidenced in various public submissions made to the Treasury and to the Senate Standing Committee on Economics.

To comply with the new law, affected taxpayers will have to keep track of various balances and transaction amounts in relation to all of their superannuation accounts, and ensure that they do not breach statutory limits. Currently, this information is often not able to be obtained instantaneously and may require time-consuming manual reconciliations.

In our view, the provision of appropriate online tools to assist taxpayers and their advisers to comply with the new law should be concomitant with these rules coming into force.

TSA urges the Government to give priority funding in the 2017-18 Budget to develop online superannuation tools relevant to the new rules.

Information which should be provided by the online tools

We suggest that the online tools include the following information for each taxpayer, in relation to each superannuation fund account held by the taxpayer. The values should be as up-to-date as at access date as is feasible (depending on the information that can be obtained from superannuation funds).

- Transfer balance cap – the individual’s applicable transfer balance cap.
- Transfer balance account – the current balance and complete transactional history starting from when the transfer balance account commenced.
- Total superannuation balance – as at current date, and also as at the end of previous financial years (from 30 June 2016).
- Unused concessional contributions cap for the year – to be calculated electronically based on concessional contributions to all funds.

The tools can be made available on myGov

In our view, the simplest and most effective method of providing the digital superannuation tools to taxpayers is to make them available on myGov.

Taxpayers with a myGov account can already log in to see their current superannuation balances in each of their superannuation funds, to request fund balance rollovers electronically and to withdraw superannuation balances held by the ATO.

New superannuation tools can be added to the existing suite of superannuation services available on myGov.

Reducing compliance burden

We emphasise the need to reduce the compliance burden on taxpayers in terms of both costs and time. Making it easy to comply will also minimise inadvertent errors and breaches of statutory caps.

Without tools to provide instantaneous, accurate data to individuals, substantial compliance costs will be incurred just to determine the relevant balances and transaction amounts that the new law requires. The compliance burden is compounded by the fact that many individuals have more than one superannuation account, and will be required to obtain the necessary information from multiple super funds.

For individuals that use an adviser, it can become very costly in fees paid to the adviser to reconcile and check balances and thresholds. This costly work has to be undertaken to ensure compliance and to determine the taxpayer's true state of affairs before any advice can be given to the taxpayer on how to adjust or manage their affairs in the future. Professional advice should primarily focus on the future rather than on determining the current state of affairs. If the new rules result in disproportionate costs and effort to comply, this could become a disincentive for taxpayers to contribute more into their superannuation accounts than the statutory minimum and invest more money from which they can self-fund their retirement.

C.2: Miscellaneous recommendations in relation to the new superannuation rules

We have reviewed the new superannuation rules that were legislated in 2016. Below are three recommendations for improving specific aspects of the new law.

C.2.1 Penalties for breach of the commutation authority requirement

Recommendation C.2.1: That the Government amends s307-80(4) of the ITAA97. Penalties for a failure by the superannuation income stream provider to comply with the commutation authority should be directed to the provider and not the superannuant.

The new s307-80 of the ITAA97, coming into force on the 1 July 2017, provides that where a commutation authority has been issued in respect of a superannuation income stream and the superannuation income stream provider is required to comply with the authority but has failed to do so, the income stream will not be in the retirement phase (subsection (4)).

The superannuation income stream will cease to be in the retirement phase from the start of the financial year in which the superannuation income stream provider failed to comply with the commutation authority and all later financial years.

The penalty is the loss of the income tax exemption on earnings. Therefore, the provision places the punitive burden on the superannuant, even if the failure to comply with the commutation authority was caused by the superannuation income stream provider and was no fault of the superannuant. This is likely to be the case for the vast majority of superannuants, except where they are also the trustee of the fund.

The penalty should be better aligned to the entity responsible for the non-compliance. Therefore we recommend substituting the loss of income tax exemption with an administrative penalty levied on the superannuation income stream provider.

C.2.2 Alternative to a court conviction for fraud or dishonesty

Recommendation C.2.2: That the Government provides an alternative to the court system for establishing that a superannuation interest is reduced because of a loss suffered by the superannuation income stream provider as a result of fraud or dishonesty.

The new transfer balance account rules provide that a “transfer balance debit” is made to the taxpayer’s transfer balance account if there is a loss to the taxpayer’s superannuation interest due to fraud or dishonesty. One of the conditions for the debit to be made is that an individual is convicted of an offence involving that fraud or dishonesty.

A practical issue with this condition is that obtaining a judicial conviction for fraud or dishonesty will likely be extremely costly and time-consuming.

We recommend that the Government amends the law to provide an alternative mechanism to establish that a superannuation fund member or a class of members suffered a loss to their superannuation interests due to fraud or dishonesty. For example, the law may be amended to empower the ATO and APRA to make a determination that fraud or dishonesty occurred. The law may also be amended to empower suitable tribunals to make a decision that fraud or dishonesty occurred. Another option is to empower the relevant Minister to make a determination that a particular class of members of the fund suffered a loss to their superannuation interests due to fraud or dishonesty.

C.2.3 Insurance proceeds from incapacity or terminal medical condition

Recommendation C.2.3: That the Government amends the law so that insurance proceeds received due to temporary or permanent incapacity or a terminal medical condition is given the same treatment as structured settlement proceeds.

The newly legislated definitions for the terms “transfer balance account” and “total superannuation balance” broadly allows for structured settlement proceeds to be excluded from calculations of relevant balances. Consequently, a receipt of structured settlement proceeds does not impact the superannuation member’s ability to make non-concessional contributions or to obtain an income tax exemption for assets supporting pensions.

We recommend that insurance proceeds received due to temporary or permanent incapacity or a terminal medical condition should be treated in the same manner. Such proceeds are expected to be spent primarily on medical treatment and/or to compensate for the loss of capacity, similarly to the proceeds from structured settlements. In our view, there should be parity of treatment between them and they should all be excluded from the calculations of account balances.

Part D: Other key issues

The following is a list of broad taxation issues which have required, but unfortunately lacked, urgent government action for some time.

Given the breadth of these topics, we have not made specific recommendations in relation to specific aspects for the 2017-18 Budget. Instead, we urge the Government to dedicate funding in the 2017-18 Budget to review these areas of taxation law and to bring about any necessary legislative change.

The taxation of trusts

We consider that creating legislative certainty in relation to the taxation treatment of trusts and the taxation of income derived by trusts (Division 6 of the ITAA 1936) should be a high priority for the Government.

The taxation of trusts has long been recognised by taxpayers, practitioners and politicians as an area in need of broad reform. In December 2010, the former government announced that it would take steps towards updating the trust income tax provisions and rewriting them into the ITAA97 (from the ITAA36). This announcement was in recognition of the “ongoing discrepancies”, “unfair outcomes”, “opportunities for taxpayers to manipulate their tax liabilities” and “major uncertainties” that arose from the trusts taxation regime.³⁷

Since that announcement over six years ago, the only major changes that have been legislated are:

- the introduction of the provisions relating to the streaming of franked distributions and capital gains – this was marked as an “interim” change to the taxation of trusts; and
- the reform of the managed investment trusts taxation regime.

Australia urgently needs trust taxation reform beyond the “interim” stage. The laws need to be robust, clear and fair and cut down compliance burdens for both business trusts and passive investment trusts. Further, the legislation should be completely rewritten into the ITAA97 rather than spread out across the ITAA36 and the ITAA97.

Groundwork analysis for the reform of trusts taxation already exists in the Board of Taxation’s *Review of Tax Impediments facing Small Business*³⁸ and in the *Australia’s Future Tax System* report.³⁹

Review of the personal services income rules

Feedback from our survey indicates that tax practitioners consider the personal services income (PSI) measures contained in Part 2-42 of the ITAA97 are unduly complicated. TSA members experience high levels of uncertainty and compliance costs in applying the PSI rules to their clients.

The rules were introduced 16 years ago (2000-01) when the nature of contract work performed was different to what it is today. In the current day, service providers operate in a global and digitalised economy and are oftentimes able to deliver products and services remotely from – and to – any location. Further, individuals are commonly applying their skills and expertise using intellectual property and intangible assets rather than using tangible items. The legislation’s reliance on concepts that are tangible in nature such as plant and equipment, tools of trade and business premises should be reviewed, and those tests expanded or updated if necessary.

In this regard, we recommend that the Government reviews the PSI measures to ensure that they are appropriate for contemporary PSI businesses. The outcome of the review may necessitate a rewrite of some or all of the PSI rules.

³⁷ Assistant Treasurer Bill Shorten, media release, *Farmers benefit with changes to trust laws*, 16 December 2010.

³⁸ See section 7.54 onwards.

³⁹ See section B2.

Further, in our view, the PSI rules are inadequate as a specific integrity measure due to the fact that there is still scope for the anti-avoidance provision of last resort, Part IVA, to apply to income splitting arrangements. We recommend that the Government reviews whether it is necessary to legislate more prescriptive rules against these tax avoidance practices so that there does not need to be a reliance on Part IVA.

Better targeting of the CGT discount

To combat the problems that Australia will face over the next few decades from an ageing population, the Government needs to urgently implement measures to encourage personal long term investment in capital appreciating assets which will generate income and capital gains on which taxpayers can rely on to fund their retirement.

Currently, the discount for individuals is 50% for a CGT asset held for longer than 12 months. This discount rate is the same regardless if the taxpayer holds the asset for 12 months and 1 day or for 20 years. We recommend that the Government considers implementing a phased system of discounting capital gains, under which the discount rate increases in proportion to the amount of time that the taxpayer has held the asset.

Commitment to long term tax reform

We urge the Government to commit to undertake comprehensive long term tax reform. Reform is vital to ensure that Australia's taxation laws are appropriate for the modern day (including contemporary modes of employment and business, and changing social norms), can robustly accommodate change, keep Australia globally competitive and will adequately provide for the country's long term spending needs.

There was widespread community disappointment when the Government abandoned its tax white paper process just over a year ago. There has been a history of successive governments promising structural tax reform but failing to deliver. For example, only a very small number of recommendations contained in the *A Future Tax System* report have been implemented, or even seriously considered, in the seven years since the release of the report in 2009.

We recommend that the Government continues the discussion that it commenced with its 2015 *Re:think* discussion paper, and construct a comprehensive tax reform plan to present to Australian taxpayers.

Improving whole-of-government use of technology

We support the Government's "digital by default" initiative to enhance the digital service delivery and information technology on a whole-of-government basis.

However, in recent times there have been a number of very serious, well-publicised technological problems at government agencies. These are the Census website crash and security breach in August 2016; the Centrelink debt letter debacle from December 2016; and the widespread ATO systems outage in December 2016.

The ATO technological breakdown has caused a lot of disruption and uncertainty for practitioners who could not complete their work as intended and for taxpayers waiting for transactions to be processed accurately. While the other two examples are not directly tax-related, they nevertheless impact taxpayers and advisers. Centrelink debts and entitlements affect tax returns and liabilities. The Census website problems cause doubt over the security of people's data hosted on government servers as well as the government's ability to provide adequate online services and capacity.

The cited examples all had serious consequences and cannot merely be put down to regular operational glitches or errors. We strongly urge the Government to prioritise resourcing for its existing reviews of these issues and ensure that any systemic problem, whether they be technological inadequacies or human errors, are fixed as soon as possible.

For tax purposes a “private company” is defined as a company that is not a public company for the year. Every company carrying on business or deriving property income in Australia must, unless specifically exempted, at all times have a public officer.