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Abstract

On 21 September 1999 Division 152 was inserted into the Income Tax Assessment Act (1997) (ITAA 1997). Division 152 contains the small business CGT concessions, which enables eligible small business taxpayers to reduce the amount of tax payable on capital gains arising from certain CGT events that occur after 11:45 am on 21 September 1999. One of the principal objectives of the legislation is to provide a concessionary regime for small business owners who do not have the same ability to access the concessionary superannuation regime generally available to employees.

When announcing the introduction of the concessions the then Federal Treasurer, Mr Peter Costello, specifically stated that the objective of Division 152 was to provide 'small business people with access to funds for retirement or expansion'. The purpose of this article is to: one, assess the extent to which small business taxpayers understand the CGT small business concessions, particularly when considering the sale of their business; two, determine which of the four small business CGT concessions are most commonly adopted and/or recommended by tax practitioners to clients; and three, to determine whether the superannuation changes in relation to the capping of the concessional superannuation thresholds have had an impact on the use of the small business retirement concession.

Keywords

small business tax, capital gains tax, tax concessions, CGT concessions, small business concessions

THE SMALL BUSINESS CGT CONCESSIONS: EVIDENCE FROM THE PERSPECTIVE OF THE TAX PRACTITIONER

KERRIE SADIQ * AND STEPHEN MARSDEN **

On 21 September 1999 Division 152 was inserted into the Income Tax Assessment Act (1997) (ITAA 1997). Division 152 contains the small business CGT concessions, which enables eligible small business taxpayers to reduce the amount of tax payable on capital gains arising from certain CGT events that occur after 11:45 am on 21 September 1999. One of the principal objectives of the legislation is to provide a concessional regime for small business owners who do not have the same ability to access the concessional superannuation regime generally available to employees.

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INTRODUCTION

According to the Australian Bureau of Statistics,¹ there were a total of 2,079,666 actively trading businesses in Australia at 30 June 2013. Of this number, a total of 1,946,659 were classified as small businesses.² Small businesses represent 93.6 percent of all businesses in Australia and employ the majority of its workforce.³ The small business sector plays such an important role that the former Prime Minister, John Howard, referred to it as the 'engine room of the Australian economy'.⁴ Yet, whilst all businesses face costs in complying with the various taxation laws and regulations, the empirical evidence reveals that tax compliance costs are highly regressive in

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¹ Australian Bureau of Statistics. 2014. *Counts of Australian Businesses, Including Entries and Exits. June 2009 to June 2013*. ABS Publication No: 8165.0. Accessed 7 May 2014. <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0>>.

² The definition of a 'small business' is one that has a turnover of less than \$2 million.

³ The greatest number of Australian small businesses were in the construction industry (16%), followed by professional, scientific and technical services (12%) and rental, hiring and real estate services (11%).

⁴ Howard, J (full name of author needed) (1997), 'More Time for Business: Statement by the Prime Minister, Commonwealth of Australia, Canberra', iii.

nature, meaning that small businesses bear a higher disproportionate share of tax compliance costs compared to larger businesses.⁵ Lignier and Evans' recent empirical research on small business compliance costs concluded that the problem has become worse in recent decades.⁶ As such, the purpose of this study is to: one, assess the extent to which small business taxpayers understand the CGT small business concessions, particularly when considering the sale of their business; two, determine which of the four small business CGT concessions are most commonly adopted and/or recommended by tax practitioners to clients; and three, to determine whether the superannuation changes in relation to the capping of the concessional superannuation thresholds have had an impact on the use of the small business retirement concession.

To partly address problems alluded to above on 28 March 2014, the Acting Assistant Treasurer, the Hon. Mathias Cormann and the Minister for Small Business, the Hon. Bruce Billson, requested that the Board of Taxation conduct a fast-track review to identify features of the taxation system that are unreasonably or unnecessarily hindering or preventing small businesses from reaching their commercial goals.⁷ One of the terms of reference for the Board of Taxation is that 'there should be a particular focus on high priority options for simplification and deregulation'. The Assistant Treasurer has requested that the Board of Taxation appoint a working group of its members to oversee the review and finalise its report to the Government by 31 August 2014. The findings contained in this study are therefore both timely and significant in terms of the small business CGT concessions.

The remainder of this article is structured as follows. Part two provides an historic perspective to the current regulatory regime, while part three provides an overview of the small business CGT concessions as well as the superannuation concessions. Part four describes the methodology used to investigate and analyses the research questions. Part five presents the research findings, discussing the understanding of the small business CGT concessions, the adoption of the concessions, the impact of recent superannuation changes and practitioner recommendations. Finally, Part six provides a conclusion and outlines the contribution of the research.

⁵ See, for example, Jeff Pope, Richard Fayle and Dongling Chen, *The Compliance Costs of Public Companies' Income Taxation in Australia*, Australian Tax Reserch Foundation, Sydney (1991); Michael Dirkis and Brett Bondfield, *The RBT ANTS Bite: Small Business the First Casualty* (2004) 19 *Australian Tax Forum* 107-158; Chris Evans, Katherine Ritchie, Binh Tran-Nam and Michael Walpole, *A Report into Taxpayer Costs of Compliance*, Commonwealth of Australia, Canberra (1997); Binh Tran-Nam, Chris Evans, Michael Walpole and Katherine Ritchie, *Tax Compliance Costs: Research Methodology and Empirical Evidence from Australia*, National Tax Journal (2000) 53(2) 229-252; Margaret McKerchar, Helen Hodgson and Michael Walpole, *Scoping Study of Small Business Compliance Costs*, Board of Taxation (2006); Chris Evans, Katherine Ritchie, Binh Tran-Nam and Michael Walpole, *A Report Into Taxpayer Costs of Compliance*. Canberra: Commonwealth of Australia, (1997) 81.

⁶ Philip Lignier and Chris Evans, *The Rise and Rise of Tax Compliance Costs for the Small Business Sector in Australia*, 10th International Tax Administration Conference (2012) Paper 5, 61.

⁷ Review of Impediments Facing Small Business. Media release on The Board of Taxation website. Accessed 7 May 2014 at: <http://www.taxboard.gov.au/content/content.aspx?doc=reviews_and_consultations/impediments_facing_small_business/default.htm&pageid=007>.

BACKGROUND

Despite the recognised importance of small businesses to the Australian economy, international comparisons indicate that the Australian capital gains tax ("CGT") regime which operated between 1985 and 1999 was relatively onerous on those same taxpayers. In particular, the Ralph Report concluded that the burden of capital gains tax fell more heavily on smaller businesses and that this had the effect of discouraging savings and investment resulting in detrimental effects to the Australian economy as a whole.⁸

Following the recommendations of the Ralph Report, on 21 September 1999, Division 152 was inserted into the Income Tax Assessment Act (1997) ('ITAA 1997') and subsequently subject to amendments in 2006. Division 152 of the ITAA 1997 contains the small business CGT concessions, which enables eligible small business taxpayers to reduce the amount of tax payable on capital gains arising from certain CGT events (including the sale of the small business itself) that occur after 11:45 am on 21 September 1999. One of the stated principal objectives at the time of introduction of the legislation was to provide a concessionary CGT regime for small business owners who do not have the same ability to access the concessionary superannuation regime (particularly the superannuation guarantee charge) generally available to employees. The then Federal Treasurer, Mr Peter Costello, when announcing the introduction of the concessions, specifically stated that the object of Division 152 was to provide 'small business people with access to funds for retirement or expansion'.⁹

In recent years, there have been several notable changes to Australia's superannuation rules which have limited the amount of money that a person can contribute into their superannuation fund. The maximum amount of concessional superannuation contributions that a taxpayer can contribute into their superannuation fund was halved from \$50,000 per annum to \$25,000 per annum in 2009-10. However, where taxpayers have access to the small business CGT regime, a lifetime limit of \$500,000 may be contributed tax free.

These changes, coupled with the recent economic downturn, mean that the small business CGT concessions may have taken on a new significance with many potential retirees now not having sufficient superannuation to allow for their retirement. Consequently, this article addresses the following three research questions: (1) assess the extent to which small business taxpayers understand the small business CGT concessions; (2) determine which of the four small business CGT concessions are being adopted and/or recommended by tax practitioners to clients; and, (3) determine whether recent halving of the concessional superannuation contribution cap from \$50,000 per annum to \$25,000 per annum, has had an impact on the use of the small business retirement concession.

⁸ Ralph, John, Rick Allert and Bob Joss (The Review of Business Taxation). 1999. Final Report, A Tax System Redesigned. Canberra: Australian Government Publishing Service. Accessed 21 August 2013. <<http://www.rbt.treasury.gov.au/publications/paper4/index.htm>>.

⁹ Peter Costello, "The New Business Tax System" (Press Release 058, 21 September 1999).

REGULATORY REGIME

Prior to an analysis of the use of the small business CGT concessions, it is necessary to briefly outline the regime itself along with the relevant superannuation concessionary regime which potentially overlaps with the CGT regime. Each is outlined in turn.

An Overview of the Small Business CGT Regime

To be eligible for the small business CGT concessions, a taxpayer must first satisfy the basic conditions set out in Section 152-10 (‘ITAA 1997’) and outlined below:

- A CGT event must happen in relation to a CGT asset in addition to one of the following:
 - a) there is a small business entity or partner in a partnership which is a small business entity; or
 - b) the maximum net asset value test is satisfied.¹⁰
- The CGT asset satisfies the active asset test.¹¹
- If the CGT asset is a share in a company or interest in a trust there must also be a CGT concession stakeholder¹² or CGT concession stakeholders in the company or trust must have a small business participation percentage¹³ of at least 90%.

Once the basic conditions have been satisfied, a small business is eligible for one (or more) of the following small business CGT concessions:

15-year exemption (Subdivision 152-B)

Under the 15-year asset exemption, an individual aged 55 or older can disregard a capital gain on assets they have held for a continuous period of 15 years if they are retiring or permanently incapacitated. A significant individual in a company or trust¹⁴ can also claim the exemption for

¹⁰ To satisfy the maximum net asset value test the net value of CGT assets of the small business, its connected entities and its affiliates must not exceed \$6 million (s 152-15 ITAA 1997).

¹¹ The asset must be an active asset just before the CGT event and for at least half of the ownership period or seven and a half years (if the asset was owned for more than 15 years) (s 152-35 ITAA 1997). An active asset is generally one that is used in the course of carrying on a business (s 152-40 (1) ITAA 1997). It can also be a share in a company or interest in a trust where the market value of the active assets of the company or trust is 80% or more of the market values of all the assets of the company or trust (s 152-40(3) ITAA 1997). A CGT asset excludes cash and financial instruments. Rental properties will generally not satisfy the active asset test.

¹² An individual will be a CGT concession stakeholder if they have a direct or indirect interest in the company or trust of at least 20%; or are the spouse of such a person and have a direct or indirect interest of greater than zero (see s152-55; s 152-60; s 152-65; s 152-70; s 152-75 ITAA 1997).

¹³ Direct or indirect interest (s 152-65 ITAA 1997).

¹⁴ Someone holding a direct or indirect interest of at least 20% (s 152-55; s 152-65 ITAA 1997).

assets held for a total period of at least 15 years.¹⁵ Where this concession applies, the other three small business concessions do not apply (Section 152-215). The capital gain is completely disregarded.

50% active asset reduction (Subdivision 152-C)

Where a business entity does not qualify for the 15-year exemption above, it may nevertheless be eligible for a 50% active asset reduction. If the basic conditions contained in Subdivision 152-A are satisfied, the net capital gain is reduced by a further 50% as long as the capital gain arose from the sale of an active asset.

Retirement exemption (Subdivision 152-D)

Under the retirement exemption, a small business individual or significant individual in a company or trust can claim an exemption on a capital gain up to a maximum lifetime limit of \$500,000 where the proceeds from the sale of the CGT assets are used for the purposes of retirement. The capital gain can be disregarded by a person aged 55 or older. If the retiree is aged under 55, the capital proceeds must be rolled over into a (complying) superannuation fund until preservation age (Section 152-305).

A taxpayer must elect in writing that this exemption is to apply to the CGT event and specify the amount that is to be treated as the CGT exempt amount. The CGT exempt amount cannot exceed a \$500,000 lifetime limit per individual.

CGT replacements asset rollover (Subdivision 152-E)

Under the CGT replacement asset rollover an individual can elect to rollover all or part of the capital gain derived from the sale of an active asset to a later date provided the basic conditions are met. This concession allows a taxpayer to rollover all or part of the capital gain derived from the sale of an active asset to a later date. According to Section 152-410, this concession only applies if the taxpayer who derived the capital gain acquired a CGT replacement (active) asset:

- one (1) year before the date of sale of the old business; or
- two (2) years after the date of sale of the old business.

If the taxpayer does not acquire a replacement CGT active asset by the end of the replacement period (ie. two years), the capital gain crystallises two years after the sale of the CGT asset (CGT Events J5 and J6). This effectively means that a taxpayer can effectively defer their CGT liability for two years after the sale of the active asset without penalty by making the election.

¹⁵ The 15 year period does not need to be continuous and the significant individual does not need to be the same person for the whole period.

Prior Research Findings

Despite the fact that Division 152 was designed to provide CGT relief for small businesses, several authors including Kenny,¹⁶ Coleman and Evans¹⁷ and Evans¹⁸ have stated that Division 152 fails the tax criteria of “simplicity” and at more than 9,000 words, is one of the most complex provisions in the ITAA 1997. As Evans points out, the irony of Division 152 is that it is aimed squarely at reducing the CGT burden placed on small businesses, however, the complexity of the legislation is self-defeating.¹⁹ In order to understand the concessions and how they should be applied to the small business taxpayer’s circumstances, professional advice is usually sought from accountants and solicitors. This is not surprising given that, according to statistics published by the ATO, more than 95 percent of business taxpayers engage a registered tax agent to manage their taxation affairs.²⁰ These small businesses therefore incur additional (usually significant) compliance and accounting costs in the form of professional advice.

In 2006, a number of amendments were made to Division 152 to reduce the compliance costs for small business as well as increase the availability of the concessions. There were two rounds of changes for 2006–07. The first round became law in April 2007 with a change made to replace the controlling individual test of a 50 percent requirement with a new significant individual 20 percent test. This test could be satisfied directly or indirectly through one or more interposed entities. This change effectively increased the number of shareholders able to access the concessions.

The second round of changes became law in June 2009 and applied retrospectively for the 2006–07 income year. These changes made the retirement exemption available for gains resulting from CGT events J5 and J6. These events occur when a taxpayer fails to meet the replacement asset conditions for the small business roll-over concession by the end of the replacement asset period. Previously, taxpayers were ineligible to use the retirement exemption for these capital gains because the basic conditions for the concessions could not be satisfied. It was always intended that the retirement exemption be available for capital gains made from these CGT events. As such, the amendments removed the requirement for CGT events J5 and J6 to meet the basic conditions in applying the retirement exemption.

The Federal Government’s stated objective in making these changes was not only to increase the availability of the CGT concessions, but also to reduce compliance costs for small businesses.

¹⁶ Kenny, Paul. (2008). ‘The 1999 review of business taxation: should we fast track small business tax reform?’ *Revenue Law Journal*, 18(1) pp. 138-167.

¹⁷ Coleman, Cynthia and Chris Evans. 2003. ‘Tax Compliance Issues for Small Business in Australia’ In *Taxing Small Business: Developing Good Tax Policies for SMEs*, edited by Neil Warren, 147-181. Sydney: Australian Tax Research Foundation.

¹⁸ Evans, Chris. 2003. ‘Studying the Studies: An Overview of Recent Research into Taxation Operating Costs’ *eJournal of Tax Research* 1 (1): 64-92.

¹⁹ Evans, Chris. 2003. ‘Studying The Studies: An Overview of Recent Research into Taxation Operating Costs’. *eJournal of Tax Research* 1 (1): 64-92.

²⁰ Australian Taxation Office (ATO). (2007). Supporting small business and tax agents. <<http://www.ato.gov.au/Media-centre/Speeches/Supporting-small-business-and-tax-agents/>>. Accessed 7 May 2014>.

Tretola agreed, stating that the amendments would indeed allow more small business taxpayers to access the concessions.²¹ On the other hand, Kenny and Demosthenous argued that the limited benefits derived from applying the small business entity tax concessions contained in Divisions 152 and 328 of the ITAA 1997 did not outweigh the associated tax compliance costs for small business.²² Further, recent studies by Lignier and Evans²³ and Marsden, Sadiq and Wilkins²⁴ also found that the small business entity tax concessions have not reduced the compliance burden for small business and the concessions may still be too complex. Despite the amendments, it is proposed that complexity is still a major hurdle to the use of Division 152.

Given that there are almost two million small businesses in Australia, it is likely that many of these business taxpayers will qualify for the small business CGT concessions when their business is ultimately sold. Furthermore, as indicated by the Federal Treasurer upon introduction of the legislation in September 1999, it is likely that many small business owners may not have adequate superannuation balances given that these taxpayers have typically invested significant amounts of private capital to establish and grow their businesses.

Superannuation Concessionary Regime

In recent years, there have been several notable changes to Australia's superannuation rules which have limited the amount of money that a person can contribute into their superannuation fund. In the 2006 Federal Budget, the Government announced that it was placing a \$50,000 concessional cap on the amount of tax-deductible contributions that a person (regardless of their age) could contribute into their superannuation fund per annum. Concessional contributions are also known as 'pre-tax' contributions. These contributions are generally taxed in the superannuation fund at 15%. Concessional superannuation contributions include any contributions made by the employer (including the compulsory 9.25% superannuation guarantee contributions (to be increased to 12% in future years), plus any additional voluntary contributions made by the employer) plus any pre-tax superannuation contributions made by the employee under an effective salary sacrifice arrangement. The maximum amount of concessional contributions that can be made into an employee's superannuation fund in any one given income year is limited to the 'concessional contributions cap'.

²¹ Tretola, John. 2009. 'Changing CGT Small Business Concessions - For Better or Worse'. *Revenue Law Journal* 19 (1).

²² Kenny, P. and Demosthenous, M. (2009). 'Wayward bullets: more small business tax concessions'. In 2009 Accounting and Finance Association of Australia and New Zealand conference. Adelaide, SA: Accounting and Finance Association of Australia and New Zealand. 2009 Accounting and Finance Association of Australia and New Zealand conference. Adelaide, SA. Jul 2009, pp. 1-24.

²³ Lignier, P., and Evans, C. 'The Rise and Rise of Tax Compliance Costs for the Small Business Sector in Australia', *Australian Tax Forum*, Volume 27, No 3, pp 615-672.

²⁴ Marsden, Stephen; Sadiq, Kerrie; and Wilkins, Timothy (2012) 'Small business entity tax concessions: Through the eyes of the practitioner'. *Revenue Law Journal*: Vol. 22: Issue. 1, Article 4.

Table 1 below summarises the concessional contributions cap thresholds for the past seven income years indicating a significant reduction in 2009-10 with no increases since then.

Table 1: Concessional Contribution Cap Thresholds (2008 to 2014)

Income year	Concessional contribution cap threshold
2013-14 ²⁵	\$25,000
2012-13	\$25,000
2011-12	\$25,000
2010-11	\$25,000
2009-10	\$25,000
2008-09	\$50,000
2007-08	\$50,000

Contributions over these cap amounts are taxed at an additional 31.5% increasing the true tax rate to 46.5%, which is equivalent to the highest marginal tax rate for an individual taxpayer.

Table 1 indicates that the concessional cap threshold went from \$50,000 in 2008-09 to \$25,000 in 2010-11 and subsequent income years. In the May 2009 Federal Budget, the Government announced the halving of the concessional contribution cap to \$25,000. The halving of the concessional contributions cap received widespread criticism with concerns raised over its impact on the retirement savings of Australians. For example, as noted by Ashenden:²⁶

For some, the impact would have been negligible. For others, however, the impact could have been more profound. Halving of the caps and resetting of indexation meant that over a 10-year period from 1 July 2007, clients were denied the ability to add an extra \$480,000 of contributions to their superannuation fund.

In accordance with Section 960-285 of the ITAA (1997), the concessional contributions cap is indexed in line with average weekly ordinary time earnings ('AWOTE'), in increments of \$5,000 (rounded down). The new indexed amount is generally available in February each year. In

²⁵ The concessional contributions cap will be temporarily increased to \$35,000 for the:

- 2013–14 income year if the taxpayer is aged 59 years or over on 30 June 2013, and
- 2014–15 income year or a later financial year if the taxpayer is aged 49 years or over on the last day of the previous income year.

The temporary higher cap is not indexed and will cease when the general concessional contributions cap is indexed to \$35,000.

²⁶ Ashenden, Bryan. 'Superannuation Contribution Caps Becoming As Simple As RBL', Money Management. Accessed 10 February 2014.
<<http://www.moneymanagement.com.au/professional-development/capability/superannuation/superannuation-contributions-caps-becoming-as-simp>>.

addition to making concessional superannuation contributions into their superannuation fund, each taxpayer is also permitted to make non-concessional superannuation contributions. Non-concessional superannuation contributions are those contributions made by the taxpayer into their superannuation fund that generally come from a taxed source. In other words, they usually represent after-tax voluntary superannuation contributions. A taxpayer is not able to claim a tax deduction for these contributions (see Sections 290-155, 290-160 and 290-165 of ITAA 1997). Furthermore, these contributions are generally not taxed in the superannuation fund.

The maximum amount of non-concessional contributions that can be made into an employee's superannuation fund in any one given income year is limited to the 'non-concessional contributions cap'. The non-concessional contribution cap threshold has been \$150,000 for the past seven income years.

In accordance with Section 292-85(2) of the ITAA 1997, the non-concessional cap for an income year is a multiple of the concessional contributions cap (currently six times). The new indexed amount is generally available each February. People aged under 65 years of age are allowed to 'bring forward' three years of non-concessional contributions and pay \$450,000 in one year provided that nothing is paid in the following two financial years. Contributions over these cap amounts are taxed at 46.5%.

Given that many small business owners may not have made sufficient superannuation contributions into their superannuation fund during the course of operating their business, it was expected that the small business retirement concession would be attractive to small business taxpayers. One reason for this is that the maximum tax-free capital gain of \$500,000 is not regarded as a concessional or non-concessional superannuation contribution, impacting the concessional and non-concessional caps outlined in Tables 1 and 2 above. A small business owner may therefore be able to boost their superannuation fund balance by up to an additional \$500,000 if they elect to roll over the proceeds from the sale of their small business into their superannuation fund.

METHODOLOGY AND DATA ANALYSIS

Due to the lack of Australian empirical research on the small business CGT concessions, a qualitative (interpretive) approach was considered most appropriate for this study. Twenty practitioners from ten chartered accountancy firms were chosen to participate in the study. The size of the firms varied with turnover ranging from less than \$1 million to over \$30 million and the number of employees ranged from less than 50 to over 200 as shown in Tables 2 and 3 below.

Table 2: Turnover of Accountancy Firms

Annual Turnover	Firms
< \$1,000,000	1
\$1,000,000 - \$9,999,999	1
\$9,000,000 - \$19,999,999	4
\$20,000,000 - \$29,999,999	2
> \$30,000,000	1
Not disclosed	1
Total	10

Table 3: Number of Employees per Accountancy Firm

Number of Employees	Firms
0 – 49	3
50 – 99	2
100 – 149	3
150 – 199	1
> 200	1
Total	10

The approximate number of clients each accountancy firm also varied considerably with the client base ranging from less than 1,000 to greater than 3,000 and the number of small business clients ranging from less than 100 to over 1,500. This is demonstrated in Tables 4 and five below.

Table 4: Number of Clients per Accountancy Firm

Number of Clients	Firms
< 1,000	3
1,000 - 1,999	1
2,000 - 2,999	0
3,000 - 3,999	3
> 3,000	3
Total	10

Table 5: Small Business Clients per Accountancy Firm

Number of SBE Clients	Firms
< 100	2
100 – 499	2
500 – 999	3
1,000 – 1499	1
> 1,500	1
Not disclosed	1
Total	10

Clients of the accountancy firms came from a broad range of industries including property, construction, professional services, entertainment, retail, manufacturing, mining, hospitality and tourism, primary production and agribusiness. As indicated in Table 6 below, the most common client business structures were companies and trusts.

Table 6: Client Business Structures

Business Structure	Firms
Company	4
Trust	1
Company and Trust	5
Total	10

The client base of the practitioners interviewed included approximately 2,750 small business clients.²⁷ The number per practitioner ranged from as low as nil (where the practitioner only advised on the Division 152 provisions when clients were referred to them from smaller divisions within their practice) to 400. Practitioners ranged in experience from manager to partner level.

The interviews with each of the 20 practitioners were conducted face-to-face at their offices during June and July 2013. Conducting interviews at the participant's workplace was done for the convenience of the participants and they may have felt more comfortable conducting the

²⁷ Those having revenue less than \$2 million or net assets less than \$6 million.

interview in a familiar environment.²⁸ Face-to-face interviewing also has advantages in that it enhances interviewer-respondent rapport and allows for the observation of non-verbal cues that may indicate confusion or hesitation on the part of the respondent when answering questions.²⁹ This may assist in strengthening the internal validity of the study as the researcher is able to probe further and clarify questions for the participant.³⁰

A semi-structured interview guide was developed containing a range of questions that specifically addressed the three research questions. The use of semi-structured interviews was viewed as the most appropriate data collection technique as the researchers sought to determine which small business CGT concessions practitioners had adopted (or recommended) on behalf of their clients. Semi-structured interviews allowed for the use of open-ended questions and probing questions, more likely to produce in-depth answers.³¹

Each interview was audio taped using a digital tape recorder with written consent being received from each respondent prior to starting the interview. This aided in more accurate data collection as it overcame the requirement to take detailed notes during the interview. This enabled the researcher to focus on ensuring the interview remained on track and free flowing whilst also leaving interviewer free to follow up questions on contentious issues or where the interviewee required some clarification.³² The length of each interview ranged from between 20 and 75 minutes. Shortly after the conclusion of each interview, the digital recording containing the interview was transcribed into an electronic text file. Each recording was transcribed by the research assistant in preparation for data analysis.

Data was entered into NVivo for detailed analysis. The data was sorted and coded according to the research questions and themes identified in the literature review. The research assistant then analysed the data by content and thematic analysis to identify patterns that matched across cases.³³

Throughout the interview process a number of practitioners noted the number of times they had applied the CGT concessions in total and then provided a percentage of the number of times they had applied each concession. Therefore, to assist in data analysis the number of times each concession was applied was determined by taking the percentage quoted by the practitioner and multiplying it by the total number of times they had applied the concessions.

²⁸ Flick, Uwe. 1998. *An Introduction to Qualitative Research*. Thousand Oaks: SAGE, 60.

²⁹ Oishi, Sabine M. 2003. *How to Conduct In-Person Interviews for Surveys*. 2nd ed. Thousand Oaks: SAGE, 6.

³⁰ Trochim, William and Donnelly, James P. 2006. *Research Methods Knowledge Base*. 3 ed. Cengage Learning Custom Publishing.

³¹ Sandford, Cedric. 1995. 'Improving the Methodologies.' In *Tax Compliance Costs Measurement and Policy*, edited by Cedric Sandford, 375-401. Perrymead: Fiscal Publications.

³² Kvale, Steiner. 2007. *Doing Interviews*. London: Sage Publications.

³³ Amaratunga, Dilanthi and David Baldry. 2001. 'Case Study Methodology as a Means of Theory Building: Performance Measurement in Facilities Management Organisations' *Work Study* 50 (3): 95-104; Perry, Chad. 1998. 'Processes of a Case Study Methodology for Postgraduate Research in Marketing' *European Journal of Marketing* 32 (9/10): 785-802; Yin, Robert K. 2003. *Case Study Research: Design and Methods*. 3 ed. Thousand Oaks: Sage, 50-51.

FINDINGS

The findings in relation to each of the three research questions are discussed in turn below in addition to recommendations made by practitioners on how the small business CGT concessions can be improved.

Understanding of the Small Business CGT Concessions

The first issue this study sought to address is the extent to which small business taxpayers understand the small business CGT concessions. Based on interviews with 20 tax practitioners, it was found that overall, small business taxpayers do not have a good understanding of the provisions, with 17 of the 20 tax practitioners (or 85 percent) ranking their clients knowledge of the provisions as either 'poor' or 'very poor'. Only three practitioners rated their client's knowledge of the concessions as "good". The full results of this question are shown in Table 7 below.

Table 7: Client Knowledge of Division 152

Knowledge of Div 152	Practitioners
Very poor	9
Poor	8
Good	3
Very good	0
Total	20

The interviews also revealed that clients are most likely to contact their tax advisor when contemplating the sale of their business or when presented with an offer to sell. The interviews revealed that small business taxpayers are almost entirely reliant on their tax advisors to explain the Division 152 concessions to them, which is consistent with the findings of Evans.³⁴ This is not surprising given the complexity of the CGT provisions, which was confirmed by the fact that 17 of the 20 tax practitioners (or 85 percent) interviewed commented that they found the Division 152 provisions either 'difficult' or 'very difficult' to apply. Only two practitioners rated the concessions 'easy' to understand. The full results of this question are shown in Table 8 below.

Table 8: Difficulty of Division 152 Provisions according to Practitioners

Difficulty	Practitioners
Very easy	0

³⁴ Evans, Chris. 2003. 'Studying the Studies: An overview of recent research into taxation operating costs' *Journal of Tax Research* 1 (1): 64-92.

Easy	2
Difficult	16
Very difficult	1
Response not included	1
Total	20

These findings are consistent with assertions made by several authors including Kenny,³⁵ Coleman and Evans³⁶ and Evans³⁷ who have all stated that Division 152 fails the tax criteria of ‘simplicity’ and is one of the most complex provisions in the ITAA 1997.

This complexity present in the eligibility rules results in the clients having high professional fees due to the amount of time spent by practitioners evaluating their client’s position and coming up with a recommendation as to whether the client is able to take advantage of one (or more) of the concessions. This proves to be costly to those small businesses who are evaluated to be just outside the threshold limit as they will incur a high cost without the offset of any associated tax benefits. It is possible that those clients that practitioners feel are on the borderline may be advised to not try to use the CGT concessions as the costs of the evaluation will be too high to justify. This would mean that due to the inherent costs associated with the concessions’ complexity, some eligible small businesses might not use the concessions as they cannot afford the risk of bearing the costs without any associated benefits. This clearly violates the ‘equity’ tax principle.

Overall, the findings suggest that clients are unable to apply the small business CGT concessions without the assistance of a tax advisor. The complexity of the provisions means that clients incur additional compliance costs, in the form of advisory fees, if they wish to apply them.

When asked which parts of Division 152 they found to be the most complex, 15 of the 20 tax practitioners (or 75 percent) believed that interpretation and application of the basic conditions was the most complex part of Division 152. It will be remembered that a small business must meet the basic conditions before one or more of the four concessions can apply. One practitioner specifically commented that they need to spend a great deal of time investigating all possible connected entities for the purpose of meeting the test. This is even more important when the sale of a CGT active asset involves capital gains in the millions of dollars and therefore carries a high level of risk. Another practitioner noted they spent approximately 75 to 85 percent of their time analysing whether their client had met the basic conditions.

³⁵ Kenny, Paul. (2008). ‘The 1999 review of business taxation: should we fast track small business tax reform?’ *Revenue Law Journal*, 18(1) pp. 138-167.

³⁶ Coleman, Cynthia and Chris Evans. 2003. ‘Tax Compliance Issues for Small Business in Australia’ In *Taxing Small Business: Developing Good Tax Policies for SMEs*, edited by Neil Warren, 147-181. Sydney: Australian Tax Research Foundation.

³⁷ Evans, Chris. 2003. ‘Studying the Studies: An overview of recent research into taxation operating costs’ *eJournal of Tax Research* 1 (1): 64-92.

One of the main complexities in analysing the basic conditions arises from having to trace through a clients structure to identify connected entities and associates and their active assets. This information is required to determine if the maximum net asset test and active asset tests are met. Another complexity noted was having to identify who the CGT concession stakeholders are and whether individually or collectively, they have at least a 90% or more small business participation percentage in a company or trust.

Despite small business taxpayers generally being reliant on their practitioners to interpret the provisions, practitioners indicated that once they had explained the concessions to their clients, the client was the one who would ultimately decide which concession to use. For example, practitioners noted that their clients would be the one who would ultimately make decisions such as choosing to defer a capital gain under the CGT replacement asset rollover for up to two years, or to roll over proceeds from the sale of the active asset into their superannuation fund. Several practitioners noted that their clients' interest in the small business CGT provisions was generally limited to the bottom line and whether they could reduce their tax.

Interestingly, none of the 20 practitioners interviewed stated that the four concessions were particularly difficult to interpret or apply. The full results of this question are shown in Table 9 below.

Table 9: Most Time Spent on Interpreting the Division 152 Provisions

Division 152	Practitioners
Basic conditions	15
Concessions	0
Response not included	5
Total	20

Despite the time and costs associated with interpreting the basic conditions in Division 152, all practitioners interviewed believed that the tax benefits flowing to their clients from applying the Division 152 concessions far outweighed the associated compliance costs, and as such, overall, believed Division 152 to be worthwhile.

Despite this conclusion, while the CGT concessions are seen to be of great benefit, the complexity of the eligibility rules are quite restricting and costly. As Tretola noted³⁸, when calling for the eligibility rules to be simplified these rules are also in need of an extensive review.

Adoption of Small Business CGT Concessions

The second research question addressed by this study was to determine which of the four small business CGT concessions contained in Subdivisions 152-B to 152-D are adopted and/or

³⁸ Tretola, John. 2009. 'Changing CGT Small Business Concessions - For Better or Worse' Revenue Law Journal 19 (1).

recommended by tax practitioners to their small business clients and the extent to which each concession has been adopted. Table 10 below outlines the number of times each of the four small business CGT concessions had been applied by the 20 tax practitioners interviewed and the number of practitioners that had applied each concession.³⁹

Table 10: Small Business CGT Concessions Used

Concession	Times Used	Practitioners
15-year exemption	45-51	11
50% active asset reduction	497-527	20
Retirement exemption	324-343	18
Replacement asset rollover	92-106	17
Total:	958 – 1,027	20

The study revealed that the first concession contained in Subdivision 152-B, namely the 15-year exemption, was the least adopted concession. Based on the findings, this concession has only been applied approximately 45 to 51 times (representing between 4.7% and 5% of occasions). Most practitioners indicated that they had only applied this concession once or twice. One practitioner interviewed specifically commented that they had used this concession on 32 separate occasions, however this was due to their particular client base. When asked why this concession was not widely used, practitioners commented that their clients simply failed to meet the eligibility requirements (ie. they had not owned the business for at least 15 years or they had not met the minimum age requirement of 55).

Not surprisingly, the most commonly used small business CGT concession is the 50% active asset reduction contained in Subdivision 152-C. All practitioners interviewed stated that they had used this concession and it had been used approximately 497 to 527 times (representing 51% of occasions).⁴⁰ Some practitioners noted that the only time they had not considered using the 50% active asset reduction was when advising on a small business sale where their client was planning to use the retirement exemption and direct as much money as possible, up to the lifetime limit of \$500,000, into a complying superannuation fund. Another restriction mentioned on the use of the 50% active asset reduction is where a small business taxpayer is a company. In this case, use of the concession could result in untaxed income in the company and therefore, the tax practitioner would recommend their client sell shares in the company rather than the assets. This approach however can result in additional costs for due diligence to take place prior to the sale.

³⁹ The table uses a range as practitioners used estimates of the number of times they had applied each concession.

⁴⁰ The number of times this concession has been applied represents a minimum only as four practitioners did not provide the number of times they had applied the concession and therefore figures for these practitioners could not be included in the total.

In accordance with expectations, the retirement exemption contained in Subdivision 152-D was also widely used. This concession had been used by 18 of the 20 practitioners interviewed and was used approximately 324 to 343 times (representing 33% of occasions). It was noted by one practitioner that this provision is generally more attractive when a small business taxpayer is over the age of 55 as they do not have to rollover the capital gain into a complying superannuation fund. Other practitioners mentioned that the retirement concession, which affords the taxpayer the opportunity of contributing a lifetime limit of up to \$500,000 tax-free into their superannuation fund was a popular concession amongst their clients because it provides an opportunity for small business taxpayers to contribute additional funds into their superannuation funds without affecting their contribution caps. This issue is discussed further below.

The third most commonly used small business CGT concession was the CGT replacement asset rollover contained in Subdivision 152-E. This was used by 17 of the 20 practitioners interviewed⁴¹ and had been applied approximately 92 to 106 times (representing 9.6% to 10.3% of occasions). Under this concession, a taxpayer is allowed to rollover all or part of the capital gain derived from the sale of an active asset to a later date. According to Section 152-410, this concession only applies if the taxpayer who derived the capital gain acquired a CGT replacement (active) asset one year before the date of sale of the old business or two years after the date of sale of the old business.

The rollover works such that the capital gain is disregarded to the extent that it does not exceed the first and second elements of the cost base of the replacement asset (Section 152-415). When asked whether this concession was used on behalf of their clients, five practitioners did not provide the number of times they had applied this concession but said that they used this concession as a general tax deferral mechanism for their clients. Under this concession, if the taxpayer does not acquire a replacement CGT active asset within the two-year period, the capital gain crystallises two years after the sale of the CGT asset (CGT Events J5 and J6). This means that a taxpayer can effectively defer their CGT liability for two years after the sale of the active asset without penalty by making the election. Several practitioners commented that many of their clients did not actually acquire a CGT replacement asset within the two year window. A few practitioners noted that at the end of the two-year period, some clients contributed the proceeds from the sale of their business into their superannuation fund under the retirement concession. Further, if the taxpayer reaches the age of 55 during the two-year deferral period, they may take up to \$500,000 of the gain tax free without having to contribute it to a superannuation fund. For this reason, some practitioners advised clients aged 53 or 54 selling their businesses to defer the gain for two years under the CGT replacement asset rollover leaving them with a choice of whether or not to contribute the gain to their superannuation fund at the end of the two year deferral period (as they would have reached the age of 55 and it was therefore not compulsory).

Apart from as a general deferral mechanism it was found that the CGT replacement asset rollover is generally used by young entrepreneurs who do not qualify for the 15-year exemption and do not want to contribute any part of the capital gain arising from the sale of their business into their superannuation fund. This is often because they plan to reinvest the money. However, generally,

⁴¹ Note that one practitioner did not respond to this question.

this concession is used less often than the other concessions as older clients that sell their business usually want to retire and are not looking to start a replacement business. These views reflect the premise that younger taxpayers are more likely to adopt this concession than older taxpayers who are closer to retirement.

Impact of Recent Superannuation Changes

The third and final issue this article sought to determine is whether the recent superannuation changes, halving the concessional superannuation contribution cap from \$50,000 to \$25,000 from 1 July 2009, has had an impact on the use of the small business retirement concession. Under the retirement concession, a small business taxpayer can roll over a capital gain of up to \$500,000 (lifetime limit) into their superannuation fund. This contribution is not only tax-free in the superannuation fund, but additionally, it does not count towards the \$25,000 concessional superannuation contribution cap or the \$150,000 non-concessional superannuation cap.

Interviewees were asked whether the halving of the concessional superannuation contribution cap from \$50,000 to \$25,000 on 1 July 2009 impacted on their client's use of the retirement concession. In other words, practitioners were asked whether they would be more likely or not to use the retirement concession. The results of this question are shown in Table 11 below.

Table 11: Impact of Superannuation Changes on Use of the Retirement Concession

Impact	Practitioners
More likely to use	11
No impact	9
Total	20

As indicated in Table 11 above, of the 20 practitioners interviewed, 11 stated they would be more likely to recommend the retirement concession as a result of the changes to the superannuation thresholds.

As previously mentioned, should a taxpayer wish to contribute more of the capital proceeds arising from the sale of their business into their superannuation fund, they can elect to forgo the 50% active asset reduction concession (which reduces the capital gain by half) and contribute the entire amount into their superannuation fund (subject to the \$500,000 lifetime limit). For example, assume that a taxpayer has sold their business and has satisfied the basic conditions contained in Section 152-10 of the ITAA (1997). The capital gain arising from the sale of the business came to \$400,000. If the taxpayer elected to use the 50% active asset reduction concession, this would have the effect of reducing the capital gain to \$200,000. If the taxpayer was close to retirement or over the age of 55, they may wish to contribute as much as possible into their superannuation fund. Applying the active asset reduction concession would result in \$200,000 being contributed into superannuation tax-free. However, if the 50% active asset reduction concession was foregone, then the taxpayer would be able to contribute \$400,000 into their superannuation fund. Hence, this simple example illustrates the incentives to adopt

particular concessions or not in order to maximise the amount contributed into superannuation. Further, as noted by a few practitioners, as the superannuation thresholds have been lowered, advisors are looking for alternatives to get as much money into superannuation funds for their clients as possible in a tax-effective manner.

It should also be noted that nine practitioners believed that the halving of the concessional superannuation cap from \$50,000 to \$25,000 would not impact on their decision to recommend the retirement concession to their clients. Several practitioners noted that the retirement concession would retain its current level of attractiveness rather than being affected by the changes to the superannuation thresholds. Two practitioners noted that changes to superannuation thresholds would not have a significant influence on this concession, as their clients would always use the lifetime limit of \$500,000 regardless of the amount of the thresholds.

Practitioner Recommendations

As part of this study each of the 20 tax practitioners interviewed were asked to provide their opinion on how the small business CGT concessions contained in Division 152 could be improved. Once again, in general, most practitioners commented that the concessions were inherently complex. Suggestions were made in relation to general amendments relating to Division 152, amendments to the basic conditions, and amendments to the four CGT concessions themselves. Each of these suggestions are summarised below.

Practitioners made one general recommendation in relation to Division 152, that is, to widen the benefit to more small businesses but making it less generous. The current regime puts a lot of pressure on practitioners to ensure that their clients qualify for the concessions since the tax benefits are so great.

Practitioners also made the following specific recommendations in relation to the basic conditions contained in Section 152-10:

- simplifying the definition of a small business entity and the maximum net asset value test particularly where connected entities and affiliates are concerned;
- annual indexation of the thresholds to determine if an entity is a small business (i.e. \$2 million turnover and \$6 million net assets);
- simplifying the definition and identification of a significant individual;
- clarification surrounding the treatment of cash and financial instruments of a company or trust in determining whether they qualify as active assets. If the active asset is an interest in a company or trust, the 80% market value of active assets test could be failed where cash and financial instruments (for example loans from one group entity to another) are not included but relate legitimately to the business;
- clarification as to whether a market valuation is required for goodwill to be classed as an active asset; and

- more guidance as to how a significant individual can be identified for non-fixed trusts in the advent of the GFC where trusts may not have not generated income and therefore made no distributions.

Practitioners made the following recommendations in relation to the four small business CGT concessions:

- relaxing the conditions for the 15-year exemption as this concession in its current form is too strict meaning that only a handful of businesses will be eligible for outright exemption under this concession;
- increasing the maximum lifetime limit under the retirement exemption above its current threshold of \$500,000. A few practitioners noted that this amount has not been increased since it was introduced in September 1999;
- extending the timeframe in which to contribute funds into a complying superannuation fund under the retirement concession if a taxpayer is under 55. Currently, the contribution must be made by the later of seven days after the choice is made to disregard the capital gain or seven days after the capital proceeds are received; and
- changing the law in relation to application of the 50% active asset reduction by companies. The current application results in half the gain being left in the company as untaxed retained earnings. Suggestions were made to amend the law such that profits could be passed to the owners without having to declare an unfranked dividend.

CONCLUSIONS AND CONTRIBUTION

The results of this study indicate that most clients do not understand the small business CGT concessions and are reliant on tax practitioners to explain the concessions to them, thus increasing their compliance costs in the form of increased professional advisory fees. This is not particularly surprising, given that the findings of this study also revealed that 85% of practitioners found the Division 152 provisions either 'difficult' or 'very difficult' to apply. Interestingly, overwhelmingly, all of the practitioners stated that they found the basic conditions in Section 152-10 harder to interpret than the concessions themselves. These findings are consistent with assertions made by other authors who have stated that Division 152 is one of the most complex provisions in the ITAA 1997. The study also revealed that of the four small business CGT concessions, the most widely used were the 50% active asset reduction (used in 51% of occasions), followed by the retirement exemption (used in 33% of occasions). The 15-year exemption was not widely adopted (used in 5% of occasions) primarily because clients rarely met the eligibility requirements (i.e. they had not owned the business for at least 15 years or they had not met the minimum age requirement of 55). Finally, it was found that just over half of the practitioners interviewed believed that the halving of the concessional superannuation caps from \$50,000 to \$25,000 from 1 July 2009 would result in them being more likely to recommend the retirement concession going forward. As part of the study, practitioners were also asked what changes they would make to the Division 152 provisions. Responses ranged from simplifying the

definitions, increasing the thresholds to providing greater clarification as to how the basic conditions and concessions are applied.

By providing accounting firms with the findings of this study as reported in this article, small business owners will benefit by becoming better placed to be long-term self funded retirees, providing not only financial benefits to the individuals and the country, but a significant increase in social self-assurance by these members of the community.