POST IMPLEMENTATION REVIEWS OF SMALL BUSINESS TAX REFORMS

1 INTRODUCTION

This paper examines the post implementation review stage[1] of enacted small business tax reforms associated with the 1999 *Review of Business Taxation* chaired by John Ralph (herein after called the *Ralph Review*).[2] Within a short period of time the *Ralph Review* made wide ranging recommendations on the design of the Australian business tax system and since 1999 many of these reforms gained assent into law.[3] Having regard to the enormity of the *Ralph Review* tax reform legislation this paper employs a partial analysis that focuses on the post implementation review processes in respect of two significant reforms, the non-commercial loss (NCL)[4] and Simplified Tax System (STS).[5] These reforms provide particularly good examples to assess the post implementation review processes given the significant flaws inherent in the legislation. The NCL rules were introduced as an integrity measure to restrict small

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[1] Australian tax reform generally follows a three stage process involving: policy formulation, legislation design and post implementation reviews'. This paper is the third in a series of three papers by the author on the tax reform processes associated with the 1999 *Review of Business Taxation* (Review of Business Taxation, *A Tax System Redesigned, More Certain, Equitable and Durable, Report* (1999) (herein after called *A Tax System Redesigned*). The author's first paper, on the policy design processes found shortcomings with the *Ralph Review's* problem identification and policy design processes. Taxation enquiries should adopt a more gradual, transparent and consultative approach in identifying and researching problems and in drafting taxation reform solutions. In particular there is a great need to carefully develop objectives for specific tax reforms and to build socio-economic modelling capabilities so as to forecast the fiscal adequacy, economic, equity and simplicity impacts as well as to assess policy outcomes. See Kenny P, 'The 1999 Review of Business Taxation: Should we fast track small business tax reform?' (2008) 18 (1) *Revenue Law Journal* 6. The author's second paper on the legislation design stage of the tax reform processes found that the rapid design of the *Ralph Review's* tax reform recommendations meant that a number of significant flaws emerged in the legislation. The federal government should have adopted a more critical analysis, as well as a transparent and consultative approach to ensure policy goals were met. See Kenny P, (2010) 'Legislative design and tax reform: The weakest link?', 25(2) *Australian Tax Forum* 179.

[2] Ibid *A Tax System Redesigned*. The Report was the last in a series of four papers published by the Review of Business Taxation.

[3] Dirkis M and Ting A, 'Cataloguing Business Tax Reform Seven Years On' (2006) 21 *Australian Tax Forum* 601, 602: Notes that the Government introduced 144 taxation bills between June 1999 and October 12001; 44 taxation and superannuation related bills in 2002; 20 in 2003; 46 in 2004; 22 in 2005; and 14 by 14 September 2006.

[4] Div 35 *Income Tax Assessment Act 1997* (Cth) (ITAA 1997).

[5] Div 328 ITAA 1997 and s 82KZM ITAA 1936 The small business concessions were known as the 'Simplified Tax System' (STS) concessions up to 30 June 2007. From 1 July 2007 the concessions were renamed as small business entities (SBE) income tax accounting concessions, *Tax Laws Amendment (Small Business) Act 2007.*

business loss deductions. The exemptions in these rules, though, greatly stymied its effectiveness. Whilst the STS was a tax expenditure aimed to help small business but it proved to be impractical. Numerous changes were made to the STS before it was abolished as a system.

This paper commences by detailing the federal Government's post implementation reviews processes for the *Ralph Review* reforms. The paper then provides an overview of the NCL and STS regimes before examining the associated post implementation reviews processes.

This paper finds that the post implementation review processes for the NCL and STS were narrowly based, ad hoc and / or untimely. The fast tracking of large scale tax reform such as the *Ralph Review* means that policy proposals and objectives may well be inappropriately conceived and the ensuing legislation may have substantial design deficiencies. Such enacted tax reforms need to be subject to a timely and thorough post implementation review process by an independent body. This process must assess the tax reforms having regard to the generally accepted tax policy criteria.[6] An effective post implementation review process also requires extensive consultation and should be ongoing.

2. THE RALPH REVIEW POST IMPLEMENTATION REVIEW PROCESSES

2.1 The "Proposed" Board of Taxation

Originally, the *Ralph Review* proposed the establishment of an advisory *Board of Taxation* (hereinafter known as the '*proposed Board'*) with seemingly wide ranging powers to review tax legislation. The *proposed Board* was to review the ongoing development of the business tax system against the national taxation objectives that are set out in a proposed *Charter of Business Taxation*.[7] This would overcome the concern of the 'largely piecemeal approach

[6] Economic efficiency, equity, simplicity and fiscal adequacy.
[7] *A Tax System Redesigned* above n 1, 102-103: 'Consistent with the function of revenue-raising, three major objectives guide the development of the business taxation system: optimising economic growth; promoting equity; and promoting simplification and certainty. The three national taxation objectives are interdependent and must be pursued jointly. Proposed changes to tax law, or to taxation administration, should take account of

which has evolved in relation to the development of business taxation policy…'.[8] The *proposed Board* would undertake the following functions:[9]

- be the guardian of the proposed Charter of Business Taxation containing the national taxation objectives and taxation design principles, and recommend changes necessary to ensure the Charter remains contemporary; …

- monitor and report on the performance of the business taxation system — and, in this regard, of the Treasury, the ATO (Australian Taxation Office) and the OPC (Office of Parliamentary Counsel) — against the objectives and principles set out in the Charter…

Under this regime the *proposed Board* would appear to have had scope to undertake post-implementation reviews of taxation laws and recommend changes in keeping with the Charter of Business Taxation. However, the federal Government rejected this recommendation to establish a *proposed Board* and thereby its Charter. [10]

2.2 The Board of Taxation Reviews

Subsequently, the Treasurer announced that federal Government would in due course 'establish an on-going, non-statutory Advisory Board which would allow access to private sector expertise on a regular basis, not only on business tax but on all aspects of tax law.'[11] Thus, in August 2000, the federal Government established the *Board of Taxation* (herein after known as the '*Board*') under a different model.[12] The *Board* was to advise on the development and implementation of taxation legislation as well as the ongoing operation of the tax system.[13] The *Board* would also ensure that there is full and effective community consultation in the design and implementation of tax legislation.[14]

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all three. Any decision to trade off one objective against another should be taken explicitly, after consideration of the anticipated advantages and disadvantages of the various options. In such instances the course which, on balance, delivers the best social outcome should be adopted. The Board of Taxation has the role of monitoring compliance with these objectives.'

[8] Ibid 119.

[9] Ibid.

[10] Costello, P., Treasurer, The New Business Tax System, Press Release No 56 of 21 September 1999.

[11] Ibid.

[12] Costello, P., Treasurer, Board of Taxation: Membership Press Release No 83 of 10 August 2000.

[13] Ibid.

[14] Ibid.

In May 2002, the Treasurer announced an expanded role for the *Board* that would see it conducting limited post-implementation reviews of major pieces of tax legislation ‘to ensure that government policy intent has been effectively translated consequent upon consultations undertaken’.[15] Since that time the *Board* was directed on an ad hoc basis to conduct post-implementation reviews of tax legislation. The *Board* has only reviewed three[16] of the many enacted *Ralph Review* reforms (including the Non-commercial Loss rules discussed in this paper).

2.3 Other Ad hoc Reviews

Treasury undertook numerous ad hoc amendments to correct technical errors and anomalies and to address obvious policy flaws. Changes were also made as a result of consequential amendments to related laws. Ad hoc post implementation reviews of the *Ralph Review reforms* were also undertaken by other bodies. For example, the STS was subject to a review by a taskforce chaired by Gary Banks (*Banks Taskforce*) to reduce the regulatory burden on small business (as discussed below).[17]

3. POST IMPLEMENTATION REVIEWS OF THE NCL RULES

3.1 *Overview of the Non-Commercial Loss Legislation*

The NCL legislation contained in Div 35 *Income Tax Assessment Act 1997* (ITAA 1997)[18] applies from 1 July 2000 to each and every income year in which an individual[19] taxpayer (whether alone or in a general law partnership[20]) is carrying on[21]

[15] Costello, P., Treasurer, Reforms to Community Consultation Processes and Agency Accountabilities in Tax Design (2002) Press Release No 22 of 2 May 2002.

[16] Non-Commercial Loss legislation contained in Div 35 *Income Tax Assessment Act 1997* (ITAA 1997; Alienation of Personal Services Income Rules Divs 84-87 and the Small Business Capital Gains Tax Concessions. Div 152.

[17] Taskforce on Reducing the Regulatory Burden on Business (Chairman, Gary Banks) *Rethinking Regulation* 31 January 2006, <http://www.regulationtaskforce.gov.au/finalreport />.

[18] Notable exceptions to the original *Ralph Reforms* were slight changes to the profits test (‘taxable income in 3 out of the last 7 years’ test which was replaced by a ‘taxable income in 3 out of the last 5 years’ test in s35-55(1)) and the introduction of an exemption for certain small primary production activities, s 35-10(4). The provisions were further amended to include an exemption for certain professional arts activities, s 35-10(4). The *Ralph Review* proposed a $20,000 annual turnover test[18] but this was replaced by more restrictive test based on $20,000 of assessable income in s 35-30.

[19] An individual means a natural person: Taxation Ruling TR 2001/14 ‘Division 35 – Non-commercial business losses’ para 34.

[20] Taxation Ruling TR 94/8 ‘Income tax: whether business is carried on in partnership (including 'husband and wife' partnerships) as to what constitutes a ‘general law partnership’.

[21] ‘Carrying on’ is defined in s 995-1 as ‘carrying on an enterprise includes doing anything in the course of the commencement or termination of the enterprise.’

a relevant business activity. Division 35 works to quarantine certain losses[22] from such small business activities unless the activity satisfies one of the exception criteria (the primary production and professional arts' exemptions, the four objective tests, or the two Commissioner's discretions. If none of these exceptions apply, the loss is quarantined and can only be offset against future profits from the business activity.[23] This carries the loss forward to the very next income year.

The NCL limitations also do not apply if the business activity is a primary production business and the taxpayer's assessable income (excluding net capital gains[24]) from other sources that do not relate to that activity is less than $40,000.[25] Further, the NCL limitations do not apply if the business activity is a professional arts business and the taxpayer's assessable income (excluding net capital gains) from other sources that do not relate to that activity is less than $40,000.[26]

The assessable income test is the first of the four objective tests and this provides that the loss deferral rule will not apply where the amount of assessable income (rather than annual turnover or taxable income) earned from the business activity for the year is at least $20,000.[27] The profits test[28] provides that the loss deferral rule will not apply for the current year if, for each of at least 3 out of the last 5 income years including the current income year, the business activity makes taxable income.[29] Under the real property test the total reduced cost base of real property or interests in real property used on a continuing basis in carrying on the business activity in the year must be at least $500,000.[30] The loss deferral rule does not apply to a business activity for an income year if the total value of assets that are counted for this test and that are used on a continuing basis in carrying on the activity in the year is at least $100,000.[31] Additionally, the Commissioner may exercise his discretion not to apply

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[22] subs 35-10(1), (2) A loss in respect of a business activity occurs where the allowable deductions attributable to that activity exceed the assessable income from the activity for an income year.
[23] subs 35-10(1), (2).
[24] Net capital gain is defined in s 995-1 as having the meaning given by ss 102-5 and 165-111.
[25] sub 35-10(4).
[26] sub 35-10(4).
[27] s 35-30.
[28] s 35-35.
[29] Assessable income from the activity exceeds deductions per s35-35(1). The profits test though ignores any NCL carried forward losses.
[30] Ibid.
[31] sub 35-45(1).

the loss deferral rule to a business activity for one or more years for businesses that have special circumstances[32] or lead times.[33]

3.2. *Rationale and Reality*

The tax policy rationale for the NCL rules were principally based on equity given that the Explanatory memorandum (EM) asserted that the measures would contribute significantly to fairness and integrity by reducing the scope for tax minimisation and the deferral of tax by taxpayers.[34] In respect of the other generally accepted tax policy criteria, the EM provided little comment on the specific impact of the NCL system on economic efficiency.[35] The forecast provided for small savings in tax revenue[36] and indicated no clear gain or loss to simplicity.[37]

However, commentators, professional and government bodies found that the NCL regime breached the tax policy criteria.[38] The various NCL exemptions enable many hobby /

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[32] The first discretion applies if the business activity was or will be affected in that or those income years by special circumstances outside the control of the operators of the business activity, para 35-55(1)(a). The special circumstances include drought, flood, bushfire or some other natural disaster, para 35-55(1)(a).
[33] This discretion has the following three requirements. First, an individual must have started to carry on a business activity for this discretion to apply. Second, the business activity must because of its nature fail to satisfy one of the four tests set out above in ss 35-30, 35-35, 35-40 or 35-45. Third, there must be an objective expectation, based on evidence from independent sources (where available) that, within a period that is commercially viable for the industry concerned, the activity will either meet one of the four tests or produce a profit.
[34] Explanatory Memorandum, *New Business Tax System (Integrity Measures) Act 2000*, paras 1.7-1.9.
[35] Ibid para 3.21. Only a generic statement on the impact on efficiency was made (found in other enacted Ralph Review reforms), that the NCL rules as part of the New Business Tax System 'will provide Australia with an internationally competitive business tax system that will create the environment for achieving higher economic growth, more jobs and improved savings'.
[36] Ibid, General outline and financial impact. The EM forecast the gain to revenue of $140 million in 2003-04.
[37] Ibid paras 3.11-3.14, 3.19. The EM asserted that the law would provide some simplification for business after an initial familiarisation period as it will provide a more consistent and easily understood business tax system. However, there maybe an increase in compliance costs for some taxpayers but this is outweighed by the improvement in the equity, fairness and integrity. The EM also stated the NCL rules would be administered by the ATO using existing resources.
[38] Samarkovski L and Freudenberg B, 'TLIP: Lip Service or in Service? A Review of the Non-Commercial Loss and STS Measures Against the TLIP principles' (2006) 21 *Australian Tax Forum* 387; Kenny P, 'The Non Commercial Loss Restrictions: A Very Blunt Instrument for Micro Business' (2006) 21 *Australian Tax Forum* 573; Greenleaf L, 'The Non-commercial loss Provisions: A Lesson in Collateral Damage?' (2006) 21 *Australian Tax Forum* 669; Rural Industries Research and Development Corporation, *Economic Effects of Income Tax Law on Investments in Australian Agriculture, With Particular Reference to New and Emerging Industries*, January 2006, <http://www.rirdc.gov.au/fullreports>; Submissions to the Board of Taxation's 'Post-implementation Review of the Quality and Effectiveness of the Non-commercial Losses Provisions in Division 35 of the *Income Tax Assessment Act 1997*', Taxpayers Australia Inc, <www.taxboard.gov.au>:

- Artists Foundation of WA;
- Arts Law Centre of Australia;

lifestyle activities to side step the loss limitation rules.[39] High income and wealthier taxpayers holding more expensive or larger scale hobby / lifestyle activities (that satisfy one or more of the four tests) are generally unaffected by the loss limitations given the quantum of these exemptions.[40] These loopholes damaged equity and the fiscal adequacy criterion. This is also economically inefficient since exempting such hobby / lifestyle activities encourages inefficient use of scarce resources.[41] These tests have an onerous affect in preventing losses for genuine business given that over 100,000 individuals are subject to the

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- Arts Law Centre of Queensland Inc;
- Australia Council for the Arts; Australian Dance Council — Ausdance Inc;
- Australian Film Commission;
- Australian Forest Growers;
- Australian Society of Authors;
- Blanckensee, Jane;
- Dunne, Ian — Lowe Lippmann, Chartered Accountants;
- Institute of Chartered Accountants in Australia;
- Leung, Bill — Lowenstein Sharp Pty Ltd,
- Certified Practising Accountants;
- Lowensteins Arts Management Pty Ltd,
- Certified Practising Accountants;
- Metcalf, Ronald Wayne — Metcalf Spahn, Certified Practising Accountants;
- Music Council of Australia;
- National Association for the Visual Arts Ltd;
- National Association of Forest Industries;
- National Tax and Accountants' Association Ltd;
- O'Brien, Peter — Hogg Lawson;
- Painters and Sculptors Association of Australia Ltd;
- Taxation Institute of Australia;
- Taxpayers Australia Inc. — Tasmanian Divisional Council;
- Tucker, Brian, Certified Practicing Accountant;
- Tree Farm Investment Managers Australia;

Watson A, *A Report to the Treasurer*' June 2004 <www.taxboard.gov.au>; BDO Kendall, *Report to the Board of Taxation Post-implementation Review on an Evaluation of Non-commercial Losses Against the Board's Review Criteria* <http://www.taxboard.gov.au/content/noncommercial_losses/Chapter_5.asp>; Australian Taxation Studies Program (ATAX), Law Faculty of The University of New South Wales, *Report to the Board of Taxation Post-implementation Review on the Operating Costs of Non-commercial Losses* <http://www.taxboard.gov.au/content/noncommercial_losses/Chapter_5.asp>; Submissions to the Board of Taxation's 'Post-implementation Review of the Quality and Effectiveness of the Non-commercial Losses Provisions in Division 35 of the *Income Tax Assessment Act 1997'*, Taxpayers Australia Inc, <www.taxboard.gov.au>; Douglas R, 'Farmers Nil, Commissioner Nil. Thanks, Ralph Great Result' (2001) 35 *Taxation in Australia* 387; Cooper G, 'Tax Reform: Non Commercial Losses' (2000) 35 *Taxation in Australia* 160.

[39] Cooper above n 38, 163; Douglas above n 38, 390-392; Kenny above n 38, 595-598; Treefarm Investment Managers submission above n 38; Greenleaf above n 38, 681.

[40] Ibid.

[41] Taxpayers Australia above n 38, 6; Taxation Institute of Australia above n 38, 2; Rural Industries Research and Development Corporation above n 38, vi.

NCL limitations.[42] Additionally, Div 35 failed to replace and simplify existing tax legislation.[43] Rather, these rules added another layer of complexity.

3.3. *NCL Post-implementation Reviews*

3.3.1 The Board of Taxation

Given the NCL flaws noted above, there appeared to have been significant pressure on the federal Government to undertake a post-implementation review. In 2002, after 2-3 years of operation of the NCL, Treasury instructed the *Board* to conduct a post-implementation examination of the NCL provisions. The *Board* was called to assess Div 35 with regard to the following criteria:[44]

- gives effect to the Government's policy intent, with compliance and administration costs commensurate with those foreshadowed in the Regulation Impact Statement for the measure;
- is expressed in a clear, simple, comprehensible and workable manner;
- avoids unintended consequences of a substantive nature;
- takes account of actual taxpayer circumstances and commercial practices;
- is consistent with other tax legislation; and
- provides certainty.

From the outset, the *Board* appears to have adopted a very limited review of Div 35 as it stated in its report: [45]

> …post implementation reviews are not intended to reopen debates about the merits of the policy underlying the legislation. Rather the intention is to gauge how effectively the legislation has been in delivering the Government's policy intent and to find out whether its implementation can be improved.

As noted above, the *Ralph Review,* originally contemplated a broader post-implementation review process for the *proposed Board.* [46] Further, the *Ralph Review* considered the

[42] Board of Taxation *Post-implementation Review* above n 38, paras 1.13-1.14.
[43] Div 35 is a complex piece of legislation and this could simplify the law if it replaces a myriad of judicial principles. However, Div 35 fails to achieve this. For example, under these rules the issue of whether a business is being carried, a major area of uncertainty, still needs to be resolved.
[44] Board of Taxation *Post Implementation Review* above n 38, para 1.2.
[45] Ibid para 1.3.
[46] *A Tax System Redesigned* above n 1, 102-103.

proposed Board's role should have been to be the guardian of the *Charter of Business Taxation* (as discussed previously).[47]

It is also apparent that the *Board*'s consultation process was constrained as the *Board* only received 24 public submissions given the 100,000 plus taxpayers having deferred losses under Div 35.[48] Not surprisingly, the submissions to the *Board* included a number of strong views concerning the structural problems in the NCL rules which fail to limit loss deductions for many hobby / lifestyle activities[49] and the way the rules defer deductions for genuine business losses.[50] The submissions also pointed to the complexity of the NCL rules.[51] The *Board*, though, declined to respond directly to these concerns because it had excluded policy issues from the scope of its examination.[52] This is considered to be a weakness in the *Board's* mandated review process.[53]

The *Board*[54] observed that the business and industry submissions to its examination[55] and the BDO Kendalls' survey results[56] reflected a strong perception that Div 35 did not take sufficient account of actual taxpayer circumstances and commercial practices. The *Board* noted that there existed confusion on what types of businesses could be grouped and what sorts of activities constituted a professional arts business.[57] Further, they uncovered an anomaly. The provisions failed to take into account the value of depreciated plant for taxpayers in the STS / SBE regimes.[58] Nevertheless, the *Board* concluded:[59]

> … the intent of the legislation was delivered in a manner that was easily understood without any substantive unintended consequences or significant compliance burdens on the community. The ATO's implementation strategy was a significant factor in the smooth implementation of this legislation.

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[47] Ibid 119.
[48] Board of Taxation *Post-implementation Review* above n 38, paras 1.13-1.14.
[49] Taxation Institute of Australia above n 38, 2; Taxpayers Australia above n 38, 6.
[50] Ibid 1.
[51] Ibid 5; Institute of Chartered Accountants 'Submission' above n 38, 2-5.
[52] Board of Taxation *Post-implementation Review* above n 38, paras 1.15-1.17.
[53] As noted above this is out of step with the *Review's* view of the post implementation process, see *A Tax System Redesigned* above n 1, 17.
[54] Ibid 1.19.
[55] Board of Taxation 'Post-implementation Review Submissions Received' above n 38.
[56] BDO Kendall *Report* above n 38.
[57] Ibid: For example what constitutes a professional arts business was in dispute in [2006] AATA 108 *Re Pedley v Federal Commissioner of Taxation* (2005) 62 ATR 1014. In this case the AAT held that the taxpayer was engaged in an installation arts business.
[58] Board of Taxation *Post-implementation Review* above n 38, para. 1.19.
[59] Ibid para 1.18.

The *Board* made the following five recommendations designed to alleviate the concerns raised in the consultation phase:[60]

Recommendation 1	The Board recommends that STS assets (excluding cars, motor cycles and similar vehicles) be counted towards the 'other assets' test in Division 35.
Recommendation 2	The Board recommends that the application form for the Commissioner's discretion and taxation rulings include additional non-primary production examples to make clear that these business activities can also qualify for the discretion.
Recommendation 3	The Board recommends that the assessment process for the Commissioner's discretion take more account of the intricacies of a particular business activity rather than relying on broad industry precedents.
Recommendation 4	The Board recommends that the ATO considers issuing additional guidance material on grouping, incorporating examples at the margin, to clarify the types of activities that may be grouped.
Recommendation 5	The Board recommends that the ATO should expedite a public ruling on what constitutes a professional arts business.

The Australian Taxation Office (ATO) promptly acted upon recommendations 2, 3, 4 and 5 and provided an administrative solution.[61] The federal Government though declined to permit the former STS depreciating assets to be included in the Other Assets test in s 35-45, reasoning that desegregation of a former STS pool for Div 35 would be inconsistent with the approach taken for STS taxpayers.[62] However, this means that STS taxpayers are dealt with more harshly under Div 35. This appears to be out of step with the goal of the STS to reduce the effective tax burden for small business[63] and the *Ralph Review's* recommendation for an integrated tax code.[64]

[60] Board of Taxation, 'Post-implementation Review of the Non-commercial Losses Legislation' Press Release No. 14, 27 April 2005, <www.taxboard.gov.au>, 4.
[61] Ibid.
[62] Ibid.
[63] Explanatory Memorandum, *New Business Tax System (Simplified Tax System) Act* 2000, paras 1.5-1.7.
[64] *A Tax System Redesigned* above n 1, 129.

Whilst the *Board* asserted that the NCL provisions improve simplicity and reduce uncertainty,[65] the analysis of commentators, professional and government bodies (noted above) shows that this is not the case. The provisions are not always expressed in a clear, simple, comprehensible and workable manner. Further, as discussed previously, these measures contain significant inequities and inefficiencies. For the *Board* to be able to conduct a thorough examination of the NCL reforms it must be given the scope to review the effectiveness of the reforms against their policy objectives and the four key tax policy criteria.

3.3.2 Adhoc Review 2002: Amendment to the Commissioners discretion

Div 35 was amended in 2002 to correct a technical defect under s 35-55(2). Subsequently, s 35-55(2) prevented the exercise of the Commissioner's discretion after the first occasion on which the business activity produces a profit or meets one of the tests, even for earlier income years, even though the period that is commercially viable may still be in course.[66] Thus, the discretion could not be exercised in income years in which losses arise following a one-off profit made from thinning out a plantation and selling the cut timber. Consequently, s 35-5(2) was amended to ensure the Commissioner's discretion could be exercised for any income year or years within the period that is commercially viable for the business activity.

3.3.3 Consequential Amendment 2006: Business Related Costs

Section 40-880 was amended to provide deductions for certain business capital expenditure incurred from 1 July 2005 but not recognised in some way elsewhere in the tax law.[67] Consequently, Div 35 was amended to take into account the certain new capital deductions for pre- and post-business expenditures deductible under the amended section 40-880. On this basis the pre- and post-business expenditures deductible under section 40-880 will not be generally prevented from being deducted against other assessable income where the pre- and post-business expenditures relates

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[65] Board of Taxation *Post-Implementation Review* above n 38, para 1.18.
[66] Explanatory Memorandum, *Taxation Laws Amendment Act (No. 1) 2002*, para 1.7.
[67] Explanatory Memorandum, Tax Laws Amendment (2006 Measures No. 1) Act 2006, para 2.9.

to a business activity that satisfies one of the tests in Division 35, or where the Commissioner exercises a discretion.[68]

3.3.4 Adhoc Review 2009: High Income Earners Limitation; Investment Allowances

Notwithstanding the serious flaws in the NCL rules (identified above) it was not until May 2009, that the new Labor Government moved to partially address these inequities. The federal Government further restricted the deductions for non-commercial losses[69] to prevent around 11,000 high wealth individuals with taxable incomes over $250,000 from claiming income tax deductions for non-commercial business activities against their other income. The Government released an exposure draft of the proposed legislation for public consultation on 26 June 2009 with the consultation period closing on 26 July 2009. [70] The EM summaries the feedback received as follows:[71]

> 2.10 Submissions raised concerns around the process for applying to the Commissioner, and the evidentiary burden for taxpayers applying for a discretion, including what constituted 'objective evidence'. The exposure draft has been amended to require applications to be made in an approved form. The form will help the taxpayer work out what information is required to be provided to the Commissioner to assess whether or not to exercise his or her discretion.
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> 2.11 Submissions also raised concerns about the continued status of discretions obtained prior to the changes in this Bill; particularly in relation to 'managed investment schemes'. Transitional provisions now ensure that all previous discretions granted by the Commissioner will continue to apply.
>
> 2.12 Consultations also raised the issue of investment allowances under Division 41 of the ITAA 1997 being quarantined to a business activity that is otherwise profitable, but because of the investment allowances makes a tax loss. The exposure draft has been amended to carve-out those investment allowances for owners of otherwise profitable businesses.

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[68] Ibid para 2.5.

69 Commonwealth Treasury Press Release No 067, ‘Improving Fairness and Integrity in the Tax System’, 12 May 2009. <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/067.htm&pageID=003&min=wms&Year=&DocType>.

[70] Explanatory Memorandum, *Tax Laws Amendment (2009 Budget Measures No. 2) Act 2009*, para 2.9

[71] Ibid.

Thus, the public consultation proved to be effective as it ensured that discretions obtained prior to these changes in the *Tax Laws Amendment (2009 Budget Measures No. 2) Act* 2009 were honoured and it raised the issue of integrating the new Div 41 (the Small Business and General Business Tax Break) with the NCL rules.

As proposed, from 1 July 2009, taxpayers with adjusted taxable incomes of over \$250,000 will only be able to deduct those expenses against the income from the non-commercial business activity.[72] It was estimated that this reform would result in the following revenue savings:[73]

2009-10	2010-11	2011-12	2012-13
Nil	\$330m	\$240m	\$130m

Whilst this reform substantially reduces the scope of the high income taxpayers to avoid the NCL limitations, there will be many taxpayers earning less than \$250,000 that will be able to avoid Div 35. Other taxpayers will manipulate their taxable income so as to fall under this threshold.

4. POST IMPLEMENTATION REVIEWS OF THE STS

4.1 *Overview of the Simplified Tax System Legislation*

The STS commenced on 1 July 2001. Under the STS, a small business first needed to work out on annual basis whether they were eligible to join or to remain in the STS. The taxpayer must have carried on a business during the year to enter the STS,[74] thus passive investors were excluded. The second requirement stipulated that the year's STS average turnover of a STS taxpayer and its grouped entities must have been less than \$1,000,000 net of GST credits and decreasing adjustments.[75] Thirdly, the STS requires that the total adjustable values[76] of depreciating assets[77] held at year end by the STS taxpayer and its grouped entities must have been less than \$3,000,000.[78]

[72] ss 35-10(1)(a), s35-10(2A), s 35-10(2E)., 35-55(1).
[73] Explanatory Memorandum, *Tax Laws Amendment (2009 Budget Measures No. 2) Act 2009,* General outline and financial impact.
[74] Former para 328-365(1)(a).
[75] Former para 328-365(1)(b). This requirement contained grouping rules that prevented large businesses from splitting or restructuring into numerous entities so they were eligible to join the STS.
[76] s 40-85.

The STS originally comprised of a package of four elements involving: accounting methods,[79] prepaid expenses,[80] capital allowances[81] and trading stock.[82] The STS provided a mandatory unique 'cash basis' style accounting method for small business income and expenses which commenced on 1 July 2001.[83] Under this method small business would account for their income and expenses on a cash basis (rather than accruals).[84] Also, under the STS, prepaid expenses were immediately deductible for STS taxpayers where the period of the benefit of the prepayment was 12 months for less.[85] Additionally, where the prepayments did not meet this requirement s 82KZM ITAA 1936 applied to pro rata deductions over the lesser of eligible service period or 10 years.

Special depreciation rules were provided for STS taxpayers.[86] STS depreciating assets were depreciated at accelerated depreciation rates by using a pool as a single depreciating asset.[87] There were two types of pools. A general STS pool for depreciating assets with an effective life of less than 25 years[88] and a long life STS pool for depreciating assets with an effective life of 25 years or more.[89] An immediate write-off applied to depreciating assets costing less than $1,000[90] Under the STS trading stock regime, where the difference between the value of the trading stock on hand at the start of an income year and the reasonably estimated value at the end of the year was less than $5,000 an STS taxpayer did not have to value each item

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[77] s 40-30.
[78] Former para 328-365(1)(c). The limit on the total value of depreciating assets that an entity and its grouped entities could have at the end of an income year ensured that large entities with low turnovers in early years of operation but with large investments in capital assets were not eligible to enter the STS.
[79] Former subdiv 328-C. Note that taxpayers who joined the STS prior to 30 June 2005 can still use the cash accounting system.
[80] s 82KZM ITAA 1936.
[81] Subdiv 328-D ITAA 1997.
[82] Subdiv 328-E.
[83] The cash accounting method was abolished prior to the advent of the SBE regime on 30 June 2005.
[84] Former subdiv 328-C. Prior to the STS, the income tax timing rules for the 'derivation' of ordinary business income and the 'incurring' of deductions for small business broadly equated with the accruals accounting system.
[85] para 82KZM(1)(aa) ITAA 1936. This replaced the former 13 month prepayment rule.
[86] subdiv 328-D ITAA 1997. Outside of the STS a uniform capital allowance system applied. Unlike the STS depreciation regime, the uniform depreciation provisions are based on the effective life of depreciating assets and broadly reflect proper financial accounting practice.
[87] sub 328-185(1).
[88] sub 328-185(2)(a).
[89] sub 328-185(2)(b).
[90] sub 328-180(1).

of trading stock at year end and account for any changes in the value of trading stock.[91]

4.2. ***Rationale and Reality***

The EM's tax policy rationale for the STS principally focused on its simplification benefits for record keeping and reporting for the small business sector.[92] The EM provided little on the specific impact of the NCL system on economic efficiency[93] and ignored its impact on equity. The STS concessions clearly breached the fiscal adequacy as seen by the EM's tax revenue loss estimates.[94]

However, commentators, professional and government bodies found that the STS breached the key tax policy criteria (like the NCL rules).[95] The STS added another layer of rules on

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[91] sub 328-285(1). Prior to the STS, small business were required to fully account for trading stock in their income tax returns in accordance with Div 70.

[92] Explanatory Memorandum, *Simplified Tax System Act 2001*, paras 1.5-1.7, 4.11-4.12, 7.9, 8.19.. The EM observed that new STS cash accounting rules would benefit small business as it minimises compliance costs for STS taxpayers because, for tax purposes, they will not be required to recognise sales for which payment has not been received and for deductions side, they will not be required to recognise expenses that they have not paid. Further, the EM stated that the new STS prepayment rules would strengthen the rules for prepaid expenses and provide simplification benefits. Additionally, the STS capital allowances rules were to provide compliance cost savings by removing or reducing the need to maintain individual asset depreciation schedules and make separate calculations for each asset for deduction and balancing charge purposes. Also, the trading stock treatment under the STS would reduce compliance costs by requiring that changes in trading stock only be brought to account in certain limited circumstances.

[93] Ibid 8.34.

[94] Ibid 8.32, 8.33.

[95] Hodgson H, 'Small business simplification – yet again?' (2007) 11 *The Tax Specialist* 140; Douglas R, 'Tax Simplification for Small to Medium Business' (2000) Taxation Institute of Australia New South Wales State Convention May 2000, 8, 10; Hine M, 'Small Business Tax System (STS)' Taxation Institute of Australia, Western Australian State Convention May 2001, 24, 29; Snook I, 'Simplified Tax System: A Favourable Current, a Riptide or Just Plain Dead Calm?' Taxation Institute of Australia, South Australian State Convention May 2001, 75, 75; Bondfield B, 'A Year on in the Simplified Tax System: has the reality matched the rhetoric?' (2002) 37 *Taxation in Australia* 253; Kenny P, 'A Simplified Tax System for Small Business: Or, Just Another Tax Preference?' (2002) 6 *The Tax Specialist* 36, 39; Tretola J, (2007) 'The Simplified Tax System - Has It Simplified Tax At All And, If So, Should It Be Extended?' (2007) 17 *Revenue Law Journal*, 4; McKerchar M, 'Is the Simplified Tax System Simple?' (2007) 10 *The Tax Specialist* 140, 141-142; Pizzacalla M, 'Australia's SME identity crisis' (2007) 22 *Australian Tax Forum* 19; Samarkovski Freudenberg above n 38; Burton M, 'The Australian Small Business Tax Concessions – Public Choice, Public Interest or Public Folly?' (2006) 21 *Australian Tax Forum* 71; CPA Australia, *Small Business Survey: Compliance Burden* (2006); Taxation Institute: Submission to the Taskforce on Reducing the Regulatory Burden on Business 28 November 2005 <www.regulationtaskforce.gov.au/submissions/sub078.rtf>; Institute of Chartered Accountants: Submission to the Taskforce on Reducing the Regulatory Burden on Business 28 November 2005; Shaw G, 'Changing to the Simplified Tax System' (2005) *Taxpayers Australia* 7 November 2005, 154; Dirkis M and Bondfield B, 'The RBT ANTS Bite: Small Business the First Casualty' (2004) 19 *Australian Tax Forum* 107; Walker G, 'The Simplified Tax System- the Good, the Bad and the Ugly' (2003) 7, 20 *CCH Tax Week* 95; Wolfers L and Miller J, 'The Simplified Tax System: Is this Government Speak for "Complex"?' (2001) 35 *Taxation in Australia* 374; Martin F, 'STS Implications' (2001) 36 *Taxation in Australia* 245; ICAA Media Release 'Chartered

top of an already complex income tax system. Division 328 also failed to provide an appropriate universal definition of a 'small business'.[96] Further, the design of the STS was intricate. The STS contained complicated eligibility rules (especially for groups).[97] The inflexibility of the STS was seen by the mandatory application of the STS cash accounting, prepayment and capital allowances concessions. The STS cash accounting basis created a number of problems for many small businesses that utilised accruals accounting and who obtained little benefit from the concessions.[98] Also, the STS cash accounting, capital allowance and trading stock rules all contained highly elaborate rules.[99]

The STS concessions were unfair since they favoured a minority of small businesses over other taxpayers. The concessions mainly benefited small businesses with significant levels of depreciating assets[100] and only provided a timing benefit from the temporary deferral of income tax.[101] This was also inefficient.[102] Reflecting the hurried implementation of the STS a number of inconsistencies arose as the STS did not always interact appropriately with the capital allowances system, capital gains tax regime and the dictionary (see the amendments noted below).

4.3 *Post Implementation Reviews of the STS*

4.3.1 *Board of Taxation*

Accountants Disappointed by Simplified Tax System Bill' 27 October 2000; Cooper G, 'The Government Response to the Ralph Report: An Initial Overview' (1999) 34 *Taxation in Australia* 232.

[96] Former s 328-365(1)(b).

[97] Former subdivs 328-F and 328-G.

[98] Tretola above n 95, 14; Kenny 'A Simplified Tax System for Small Business' above n 95, 37; Snook above n 95, 77-78; Wolfers Miller above n 95, 376; Douglas above n 95, 11; Bondfield above n 95, 332-334.

[99] Former subdivs 328-C, 328-D, 328-E ITAA 1997.

[100] *A Tax System Redesigned* above n 1, 721.

[101] Former subdivs 328-C, 328-D, 328-E ITAA 1997, s82KZM ITAA 1936

[102] The STS discriminates against low income, small business taxpayers such as 'start up' businesses since they face a zero or low marginal income tax rate. For such businesses, the value of a tax benefit under the STS concessions is negligible or nil. It is apparent from the *Review's* tax revenue modelling that the STS depreciation concessions provides the primary benefit to small business. Thus small businesses involved in capital intensive sectors of the economy such as the agriculture, forestry, fishing, mining, manufacturing, construction and transport sectors benefit. Other sectors such as retail and professional service providers obtained little benefit. See *A Tax System Redesigned* above n 1, 721.

Over its six year life the STS did not prove to very popular with small business[103] and was subject to significant and sustained levels of criticism by commentators, professional and government bodies (as noted previously). The *Board*, though, was not tasked with the post-implementation review of the STS. This is out of step with the stated aim of the *Ralph Review's* recommendation that enacted tax preferences be periodically and systematically reviewed against their objectives.[104]

It was only after the cessation of the STS, in December 2007 that the *Board* upon the request of the Treasurer, completed a scoping study of small business tax compliance costs.[105] The *Board* was asked to identify the key factors that influence small business compliance costs and provide some guidance on the issues that should be considered in reducing compliance costs for small business.[106] As part of the review the *Board* belatedly was able to examine the STS. Its conversations with tax agents indicated that many STS clients were ignorant of the existence of the STS.[107] The tax agents decided for their client whether they should elect to join.[108] The STS taxpayers that were aware of the STS could not determine whether the STS would benefit their business given its complexity.[109] The *Board's* consultations with tax agents further found that they were not generally supportive of the STS. The broad comments from tax agents were:[110]

- The initial STS requirement (until 2005) for businesses to use cash accounting was inconvenient and unpopular because tax agents were more accustomed to accrual accounting and some of their clients preferred up-front deductions for expenses that are incurred but not yet paid.
- Some tax agents perceived the benefits were too modest and only useful for small businesses that could benefit from accelerated depreciation.
- When it was introduced in 2002 many tax agents were still getting across the relatively new GST, so tax agents did not have the time to consider its merits.
- It was an all-or-nothing package and while some elements may have benefited particular small businesses, others may not.

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[103] ATO Tax Practitioners Forum Issues Log (register n, A27), <www.ato.gov.au/taxprofessionals/contentasp?doc+/content/39983.htm&page=165&H28_1> on 29/11/06. Only 14 per cent of small business had joined the STS in the year ended 30 June 2002.[103]
[104] *A Tax System Redesigned* above n 1, 275-276.
[105] Board of Taxation, Study of Small Business Tax Compliance Costs, Report to the Treasurer (2007), <http://www.taxboard.gov.au/content/content.aspx?doc=reviews_and_consultations/small_business_tax_compliance_costs/default.htm&pageid=00>.
[106] Ibid
[107] Ibid 93.
[108] Ibid.
[109] Ibid.
[110] Ibid.

• The various criteria and thresholds for entry increased compliance costs.

In reviewing the new Small Business Entities (SBE) regime (that replaced the STS) the *Board* adopted a proactive stance, stating that 'a post-implementation review of the SBE regime in two to three years time may be useful.'[111]

4.3.2 Consequential Amendment 2001: Research and development activities

As a result of changes in the treatment of expenditure on plant/assets used for research and development, the deductions for depreciating assets used in carrying on research and development activities are worked out under section 73BA ITAA 1936 from 1 July 2001.[112] As a consequence the STS depreciation rules were amended to exclude a deduction for amounts in respect of depreciating assets used in carrying on research and development activities that were worked out under section 73BA.

4.3.3 Adhoc Review 2002: STS interaction with other provisions in the ITAA 1997

Reflecting the hurried implementation of the STS a number of inconsistencies arose. Consequently, *Taxation Laws Amendment Act (No. 5) 2002* attempted to ensure that the STS capital allowances system operates as intended and interacted appropriately with the capital allowances system, capital gains tax regime and the dictionary.

Note 2 of subsection 40-25(1) was amended to reflect the fact that an STS taxpayer both deducts and works out the amount they could deduct, under Division 328 (whilst s 40-25(1) provides a deduction equal to the decline in value of an asset that is held by a taxpayer during an income year).

Subsection 40-215(1) inadvertently omitted a reference to the STS. Section 40-215 ensures that the cost of any depreciating assets for which a deduction is allowable under Division 40 is not reduced. Consequently an amendment was made to insert the words 'or Division 328'

[111] Ibid 94.
[112] Explanatory Memorandum, *Taxation Laws Amendment (Research and Development) Act 2001* paras 2.1 -2.6.

in s 40-215(1). This meant that the cost of a depreciating asset was not reduced by any deduction allowable under Division 328.[113]

The capital gains tax rules in paragraph 104-235(4)(b) were amended to remove the reference to decline in value in relation to the STS. The STS does not refer 'to decline in value'. This ensured the terminology used is consistent.

The STS depreciation rules in 328-175(6) were amended to allow a deduction to be claimed under the capital allowance unless it was 'reasonably expected' that the depreciating asset would be predominantly leased in the future (rather than 'intended'). This would provide greater clarity since taxpayers would not always be in a position to know how a depreciating asset is intended to be used, they may have had difficulty in interpreting this provision.[114]

The STS depreciating asset rules were further amended to allow a deduction for a cost addition of less than $1,000 for a low cost asset in the year of purchase.[115] If the cost of the addition is $1,000 or more, including subsequent cost additions of any value, both the cost addition and the underlying low cost asset were added to the general STS pool.[116] Further, s 328-180(2) would also allow a cost addition of $1,000 or more for a low cost asset, and any subsequent cost additions, regardless of their cost, to be added to a pool, even after the STS taxpayer has left the STS.

To correct a technical error subsection 328-225(3) was amended to omit the words 'the end of' and substitute 'the beginning of'. This ensured that, in determining the adjustment to the opening pool balance where there has been a change in the business use of an asset, only those cost additions made to the asset until the beginning of the income year in which the adjustment applies were included in the asset value.[117]

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[113] Explanatory Memorandum, *Taxation Laws Amendment Act (No. 5) 2002* para 3.106.
[114] Ibid para 3.108.
[115] 328-180(2).
[116] Ibid; Explanatory Memorandum *Taxation Laws Amendment Act (No. 5) 2002* para 3.109.
[117] Ibid para 3.111.

The amendments also included belated updates to the definitions in s 995-1 for the STS in respect of the capital allowances definition (to include the STS) and for defining expenditure on in-house software (to include the STS).[118]

4.3.4 Adhoc Review 2004: STS roll-over relief

It appears that in response to a number of concerns about the STS the federal Government implemented a series of amendments to the STS to make it more attractive to small business. First, an anomaly for a 'simpler' system for small business was fixed. The STS capital allowance rules in subdiv 328-D did not originally provide for any roll over relief for depreciating assets (unlike Div 40 that was available for non-STS partnership taxpayers). To encourage the uptake of the STS[119] optional roll-over relief was provided.[120] Roll-over relief was only available where the entities both before and after the change are partnerships. Roll-over relief for partnerships in the STS ensured that the transferor taxpayer ignored the balancing adjustment amount at the time of the partnership change so that no amount was included in its assessable income.

4.3.5 Adhoc Review 2005: STS accounting method; Further STS roll-over relief; the STS entrepreneurs discount

The STS cash accounting basis created a number of problems for many small businesses that utilised accruals accounting and who obtained little benefit from the concessions.[121] Consequently, the cash accounting system was abandoned from 1 July 2005.[122] As the EM stated, the 'removal of the cash accounting requirement will enable more businesses to access the benefits of the STS whilst calculating their

[118] Ibid paras 3.112. 3.113.
[119] Explanatory Memorandum, *Taxation Laws Amendment Act (No. 2) 2004*, para 7.5 states 'Roll-over relief is not currently available for reconstitutions of partnerships operating under the STS (i.e. STS partnerships), deterring some taxpayers from joining the STS. This measure will allow optional roll-over relief for STS partnerships subject to certain conditions.'
[120] The former s 328-240; ss 328-243, 328-245.
[121] Tretola above n 95, 14; Kenny 'A Simplified Tax System for Small Business' above n 95, 37; Snook above n 95, 77-78; Wolfers Miller above n 95, 376; Douglas above n 95, 11; Bondfield above n 95, 332-334.
[122] *Tax Laws Amendment (2004 Measures No. 7) Act 2005*, Sch 2. STS taxpayers that joined before 1 July 2005, though, could continue to use the cash accounting basis. See s 328-100 *Income Tax Transitional Provisions Act 1997* (ITTPA 1997).

taxable income using the most appropriate method applicable to their circumstances.'[123] It took four years, though, to fix this obvious flaw in the STS.

In another anomaly for a 'simplified' system, under the STS roll-over relief was only available where the entities both before and after the change were partnerships. Thus optional roll-over relief was extended under subsection 40-340(3) to balancing adjustment events occurring in relation to depreciating assets in an STS pool under subsection 40-295(2). This would occur where a change occurs in the holding of, or in interests of entities in, the asset; at least one of the entities that had an interest in the asset before the change has an interest in the asset after the change; and the asset was a partnership asset either before or as a result of the change.[124]

A 25 per cent entrepreneurs' tax offset was introduced in respect of the income tax payable on business income for STS taxpayers that have an annual turnover of $75,000 or less. Where STS turnover is greater than $50,000 the offset is phased out so that the offset ceases once STS turnover reaches $75,000. The EM provided the following rationale:[125]

> In the 2004 election policy statement Promoting an Enterprise Culture, the Government announced a number of measures designed to foster the entrepreneurial spirit of small businesses. The Government stated that it would provide further incentive and encouragement to small businesses - particularly those that set up and operate from home - through the introduction of a tax offset for entrepreneurs. This proposal is targeted at very small, micro and home-based businesses that are in the STS.

However, this measure would cost the revenue $400 million in 2006-07 and $390 million in 2007-08.[126] Rather than fixing the flaws in the STS this measure created more inequities and inefficiencies since the offset mainly benefits STS taxpayers with higher turnovers near the $75,000 cut off that have few deductions. Other taxpayers

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[123] Explanatory Memorandum, *Tax Laws Amendment (2004 Measures No. 7) Act 2005*, General outline and financial impact.
[124] Ibid: The EM stated: 'This amendment ensures that roll-over relief is available if there is a change in business structure involving a partnership. For example, if a sole trader takes on a new partner, roll-over relief will be available to defer any adjustment to taxable income resulting from that balancing adjustment event. Likewise, if a partner leaves a partnership and the remaining partner carries on as a sole trader, roll-over relief will be available.'
[125] Ibid.
[126] Ibid.

received little or no benefit from this measure. This added to compliance costs for small businesses who needed to separate out gross business income and their deductions incurred in gaining that income in order to calculate the net business income. Further, the Australian Taxation Office (ATO) incurred additional administration costs in managing the new STS concession. Overall, this measure appears to have breached all of the tax policy criteria. This appears to have been a vote gathering exercise designed for the 2004 election.

4.3.6 The Banks Taskforce: 2007 Small Business Entities replaces the STS

On 12 October 2005 the former Coalition Government established a taskforce chaired by Gary Banks (*Banks Taskforce*) to reduce the regulatory burden on small business.[127] The *Banks Taskforce's* report *Rethinking Regulation* was provided to the federal Government on 31 January 2006.[128] The submissions to the *Banks Taskforce* called for a consistent definition of small business.[129] The *Banks Taskforce* consequently found that there was a need to harmonise taxation law definitions and recommended that the definition of a small business be aligned or rationalised. [130]

After some delay, on 1 July 2007, the federal Government renamed and modified the STS in Div 328 as part of the new 'Small Business Entities' (SBE) regime in order to simplify the various small business concessions.[131] Under the SBE rules the former STS depreciation, prepayment and trading stock income tax accounting concessions were retained with some minor modifications. The new SBE definition of a small business was also aligned with a number of other small business concessions.[132]

The SBE test provided a new measure for determining what constitutes a small business.[133] From 1 July 2007 SBE have the choice to apply any of the SBE concessions since they are no longer compulsory,[134] unlike most of the former STS

[127] Banks Taskforce above n 17.
[128] Ibid.
[129] Ibid.
[130] Ibid 169-170, Recommendation 5.43.
[131] *Tax Laws Amendment (Small Business) Act 2007.*
[132] Subdiv 328-C ITAA 1997.
[133] s 328-110(1).
[134] s 328-110(1).

concessions.[135] Under the SBE rules there is no need to lodge an election with the Australian Taxation Office to access the concessions.[136] The former $1 million STS average turnover threshold[137] was replaced with a $2 million aggregate turnover threshold[138] and the former STS $3 million depreciating assets test was abolished.[139] The removal of the depreciating asset limit, though, structurally damaged the integrity of the SBE definition of a small business. Under this SBE definition large and medium sized businesses (such as mining companies) will constitute SBE during their start up periods when they will satisfy the $2 million turnover threshold.

The SBE test now applied to the following concessions:[140]

- CGT 15-year asset exemption Subdivision 152-B ITAA 1997
- CGT 50% active asset reduction Subdivision 152-C
- CGT retirement exemption Subdivision 152-D
- CGT roll-over Subdivision 152-E
- Simpler depreciation rules Subdivision 328-D
- Simplified trading stock rules Subdivision 328-E
- Deducting certain prepaid business expenses immediately Sections 82KZM and 82KZMD of the Income Tax Assessment Act 1936
- Accounting for GST on a cash basis Section 29-40 of the GST Act
- Annual apportionment of input tax credits for acquisitions and importations that are partly creditable Section 131-5 of the GST Act
- Paying GST by quarterly instalments Section 162-5 of the GST Act
- FBT car parking exemption Section 58GA of the Fringe Benefits Tax Assessment Act 1986
- PAYG instalments based on GDP-adjusted notional tax Section 45-130 of Schedule 1 to the Taxation Administration Act 1953

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[135] Former subdivs 328-C, 328-D ITAA 1997, s82KZM ITAA 1936.
[136] Subdivs 328-D, 328-E ITAA 1997, s82KZM ITAA 1936.
[137] Former s 328-365(1)(b) ITAA 1997.
[138] s 328-110(1)(b).
[139] s 328-110(1).
[140] s 328-10(1).

Consequential amendments were made to the above provisions to introduce the new term of SBE and to replace all former small business references (such as ‘STS taxpayers’). However, some of the above concessions impose alternative tests to the SBE requirements. This undermines the simplicity benefit that could have been achieved from having a single definition of small business.[141] For example, the small business capital gains tax concessions utilise an alternative $6 million net assets test.[142] This breaches the *Ralph Review's* recommendation of an integrated tax code having ‘a common dictionary to ensure consistency and greater standardisation of concepts across the Code’.[143]

The former STS entry and exit rules in subdivs 328-F and 328-G were repealed as they are unnecessary under the fully optional SBE regime.[144] However, complex transitional rules were introduced to cater for the move from the STS to the SBE regime.[145]

Overall, the new SBE regime retained the tax concessions of the former STS and thereby favoured a limited number of small businesses. As a result the inequities and inefficiencies of the STS (discussed previously) continue to exist in the SBE regime.

5. CONCLUSION

This partial analysis illustrates the short comings of the narrow ad hoc post implementation review processes for the enacted *Ralph Review reforms*. The two *Ralph Review* reforms examined, the NCL and STS, both contained significant flaws yet these were not addressed in a timely and effective fashion. It took nine years before action was taken to address some of the problems with the NCL rules and six years to address some of the issues with the STS. Given that the ad hoc review processes were limited in scope they did not fully address the underlying policy flaws.

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[141] Hodgson above n 95, 140.
[142] s 152-15.
[143] *A Tax System Redesigned* above n 1, 129.
[144] Explanatory Memorandum *Tax Laws Amendment (Small Business) Act 2007* para 4.33.
[145] *Tax Laws Amendment (Small Business) Act 2007*,pages 49-56.

The speed and the complexity of the *Ralph Review's* proposal development and the legislation design stages of tax reform means that policy proposals and objectives may well be inappropriately conceived and legislation may have substantial design deficiencies. One of the key lessons to emerge from such fast tracking of large scale tax reform is that such enacted tax reforms need to be subject to a timely and thorough post implementation review process by an independent body (perhaps 2-3 years after implementation).[146] Regard must be had to the views of the general community, academic and professional commentators, professional and government bodies in assessing how well the policy goals are met.

[146] *A Tax System Redesigned* above n 1, 275-276. As the ignored *Ralph Review* recommendation asserted, enacted tax preferences (such as those contained in the NCL rules) should be periodically and systematically reviewed against their objectives.