Yet another round of problematic small business tax concessions

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Running or advising a small business is becoming more complicated given the numerous twists and turns of government policy in respect of the small business entity (SBE) concessions. The timing of asset purchases for effective tax planning is particularly tricky given the frequent changes in depreciation rates and immediate deduction limits. The introduction of differential income tax rates for SBEs also raises new tax planning opportunities and challenges. This article examines the 2015 Budget SBE proposals. The Tax Laws Amendment (Small Business Measures No 2) Bill 2015 (Cth) will provide accelerated depreciation for small businesses and primary producers. The Tax Laws Amendment (Small Business Measures No 1) Bill 2015 (Cth) will reduce the company tax rate from 30% to 28.5% for companies that are SBEs.

Accelerated depreciation for SBEs

Rationale

The Tax Laws Amendment (Small Business Measures No 2) Bill 2015 provides the following rationale:

While it is businesses that create jobs, there is a clear role for Government to address impediments and create the right conditions for Australian small businesses to grow and become more productive. With the economy facing below-trend growth, the Government’s objective is to stimulate small business investment, growth and employment. The Australian economy is in transition. The declining terms of trade and the ageing of the population are placing downward pressure on income growth. Small business is a key driver of Australia’s economy, underpinning growth and innovation and providing jobs for millions of Australians.

Small businesses are typically more vulnerable to shocks and changes in economic conditions than larger businesses. This makes it particularly important that, during this period of economic transition, the policy settings support small business growth and innovation. This proposal will encourage small businesses to invest in the assets they need to grow and service their customers.

Providing small businesses with a $20,000 threshold for immediate deduction encourages investment. Investment is important as it leads to existing output being produced at a lower cost and new and improved ways of doing business (innovation), which improves the amount of output produced for each unit of input, including labour (productivity). As a result, higher investment can lead to both higher employment and wages over time.

The $20,000 immediate write off threshold

The Bill will temporarily increase to immediate write off threshold to $20,000 under which certain depreciating assets, costs incurred in relation to depreciating assets and general small business pools can be written off. The asset must first be acquired at or after 7.30 pm (by legal time in the Australian Capital Territory) on 12 May 2015 and first used or installed ready for use on or before 30 June 2017. Previously, SBEs could only claim an immediate deduction for depreciating assets that cost less than $1000 in the income year the asset is first used or installed ready for use.

Also, SBEs can claim a deduction for an amount included in the second element of the cost of depreciating assets that are first used or installed ready for use in a previous income year. The total amount of the cost must be less than $20,000 and the cost must be incurred at or after 7.30 pm (by legal time in the Australian Capital Territory) on 12 May 2015 and on or before 30 June 2017. Previously, SBEs could only claim a deduction for an amount included in the second element of the cost of depreciating assets that are first used or installed ready for use in a previous income year where the amount of the cost is less than $1000.

Further if the balance of a SBE’s general small business pool is less than $20,000 at the end of an income year, the SBE can claim a deduction for the whole balance of the pool. The income year must end on or after 12 May 2015 and on or before 30 June 2017. Previously, the SBE could only claim a deduction for the entire balance of the pool if the general small business pool is less than $1000 at the end of an income year.

The increased $20,000 threshold also applies to SBEs that previously opted out of the SBE capital allowance provisions (that is, the 5 year lock out rule does not apply). For the purposes of applying the lock out rule to an income year after 30 June 2017, only the choice made in the last income year ending on or before 30 June 2017 is relevant. Previously, a SBE that elects to apply the small business capital allowance provisions and then opts out in a later income, is not able to apply the small business entity capital allowance provisions until 5 years after they opted out.
Primary producer capital allowance proposals

Rationale

The Tax Laws Amendment (Small Business Measures No 2) Bill 2015 provided the following rationale:³

The consultation process for the ACWP has indicated that there are issues with the depreciation arrangements for different assets, such as the long period required to recoup initial capital expenditure and costs incurred in depreciating assets over time. As a result, primary producers may undertake too little investment in preparing for drought. While the Government can’t prevent drought, there is a clear role for Government to address impediments and create the right conditions for farmers to invest for the future. Accelerated depreciation encourages farmers to better manage and mitigate the risks of severe weather events, which can in turn reduce the significant cost on the Government in responding to drought. On 9 May 2015, the Government announced new funding of $333 million to support farmers, farm businesses and rural communities affected by drought.

The concessions

The capital allowance proposals also allow primary producers to claim an immediate deduction for capital expenditure on water facilities and fencing assets, and to deduct capital expenditure on fodder storage assets over 3 years. Previously, primary producers could deduct capital expenditure on a fodder storage asset or a fencing asset over the effective life of the asset and deduct capital expenditure on a water facility over 3 years.

The Australian Taxation Office (ATO) has advised that primary producers can choose between the new accelerated depreciation for primary producers and the above instant asset write-off changes on an asset-by-asset basis.⁴

Small business company tax cut

Rationale

The Tax Laws Amendment (Small Business Measures No 1) Bill 2015 provides the following rationale:⁵

While it is businesses which create jobs, there is a clear role for Government to address impediments and create the right conditions for Australian small businesses to grow and become more productive, creating more jobs. With the economy facing below-trend growth, the Government’s objective is to stimulate small business growth and employment, through reduced tax and regulatory barriers. The Australian economy is in transition. The declining terms of trade and the ageing of the population are placing downward pressure on income growth. Small businesses are a key driver of Australia’s economy, underpinning growth and innovation and providing jobs for millions of Australians.

Small businesses are typically more vulnerable to shocks and changes in economic conditions than larger businesses. This makes it particularly important that, during this period of economic transition, the policy settings support small business growth and innovation. This proposal will deliver lower taxes to incorporated small businesses to help them grow.

Providing incorporated small businesses with a reduced rate of company tax will permit them to retain more earnings for investment. Investment is important as it leads to existing output being produced at a lower cost (capital deepening) and new and improved ways of doing business (innovation), which improves the amount of output produced for each unit of input, including labour (productivity). As a result, higher investment can lead to higher employment and wages over time. However, given the small size of these companies, the overall macroeconomic impact is unlikely to be as significant compared to a broader tax cut to all companies.

Under the Bill the corporate tax rate for SBE companies will be 28.5%. The corporate tax rate for companies that have an aggregate turnover of $2 million or more will be 30%. The amendments will apply for the first income year beginning on or after 1 July 2015 and for subsequent income years. The maximum franking credit that can be allocated to a frankable distribution is based on a tax rate of 30% for all companies.

Good policy?

Have the lessons been learned from the failures of the Simplified Tax System?⁶ The current proposals are out of step with the Henry Review’s recommendation for a comprehensive income tax,⁷ and the Mirrlees Review’s (UK) and Buckle Review’s⁸ (New Zealand) proposal for equal treatment of income derived from employment, self-employment and running a small company.⁹ The measures are inequitable and inefficient given the small number of likely (affluent) winners benefiting from the policy and it fails fiscal adequacy. The concessions add to complexity.

In 2010 I asserted the tax reform processes need to:¹⁰

…quantify the impacts of their proposals on the core tax policy objectives (fiscal adequacy, economic efficiency, equity and simplicity) how can policy makers be confident that policy objectives will be met and / or that the community will be in a better overall position? Thus, a quantification of the policy impacts should be made and documented in the Regulation Impact Statements accompanying the draft bills. If there are inadequate resources in the federal Government to effectively quantify the four policy criteria then a qualitative assessment must be made and detailed. These qualitative assessments should be documented in the Regulation Impact Statements accompanying the draft bills. … Second, the policy rationale must seriously consider all four tax policy criteria and the policy trade-offs should be recognised.

Third, effective consultation processes must be followed before finalising the design of the legislation. The speed of such as processes as the Ralph and Henry Reviews means that there is little effective consultation. Consultation with the wider community, the identification of winners and
losers, becomes even more vital where tax reform processes are unable or fail to quantify the policy impacts.

Overall, there is insufficient evidence to support the design of this proposal for SBEs and there appears little prospect for consultative, transparent and effective tax reform. There are few resources allocated to the design stage of tax law and legislation design continues to be the weakest link in the Australian taxation system.

The Tax Laws Amendment (Small Business Measures) Bills passed the Parliament on 15 June 2015.

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Footnotes
1. That have an aggregated turnover of less than $2 million.
2. Tax Laws Amendment (Small Business Measures No 2) Bill 2015 Explanatory Memorandum, paras 1.60–1.63.
3. Above n 2, paras 2.68–2.69.
5. Tax Laws Amendment (Small Business Measures No 1) Bill 2015 Explanatory Memorandum, paras 2.13–2.16.
11. Fenton-Jones M “Accountants feel left out of tax review” (2009) Australian Financial Review, 49. Where it is cited that Sage HandiSoft, a business software provider, conducted a survey of 6400 accountants asking them for their views on the conduct of the Henry Review. About 60% responded and said that consultation with the accounting profession had not been adequate. Half wanted to contribute to the Review but did not know how to go about it.