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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Online: economics.sen@aph.gov.au

Dear Sir/ Madam

Treasury Laws Amendment (2019 Tax Integrity And Other Measures No. 1) Bill 2019

CPA Australia represents the diverse interests of more than 164,000 members working in 150 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

The measures contained within the Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Bill 2019 are broadly supported by CPA Australia, noting that:

- Issues relating to partnership assignments, service trusts and professional services firms are not wholly resolved by the amendment to the small business CGT concessions and further legislative and administrative guidance is required to provide clarity and certainty to the industry.
- The vacant land provisions have the potential to affect entities earning assessable rental income from vacant land where they do not satisfy the requirements for carrying on a business. There are also certain situations where the cost cannot be claimed either on revenue or capital account.
- CPA Australia remains concerned about the potentially punitive nature of the proposal to allow the ATO to disclose outstanding business tax debts to a credit reporting bureau. The disclosure of business tax debts needs to be carefully administered to ensure that businesses are not unduly or unfairly impacted by the policy.
- CPA Australia does not typically support retrospective application of legislation as taxpayers and their advisors operate on the basis of the law as it stands at the time. Retrospective application can impose additional costs or affect the feasibility or structure of transactions with no recourse available to the taxpayer.

Specific comments in relation to each of the Schedules are contained in the Attachment.

If you have any queries do not hesitate to contact Gavan Ord, Manager Business and Investment Policy at CPA Australia on gavan.ord@cpaaustralia.com.au or 03 9606 9695.

Yours sincerely

Dr Gary Pflugrath CPA

Head of Policy and Advocacy
CPA Australia

Schedule 1 – Tax treatment of concessional loans involving tax exempt entities

No comment.

Schedule 2 – Enhancing the integrity of the small business CGT concessions in relation to partnerships

CPA Australia supports the integrity provision, but does not support retrospectivity given transactions undertaken in the period between announcement and assent may otherwise not have occurred or differed in their terms. In changing from the legislation as it stood at the time, there may be negative taxpayer impacts arising from changes in asset values and earn-out arrangements.

Outstanding issues remain with respect to partnership assignments and professional services firm structures. The bigger issue for practitioners is in relation to service trusts, as there is great uncertainty in the industry following both the ATO's withdrawal of its previous guidance and the delay(s) in issuing new guidance.

Schedule 3 – Limiting deductions for vacant land

CPA Australia supports the intent of this integrity provision. However, we are concerned that the Bill does not fully consider the range of situations that might be captured by the measure. The interplay between the denied deductions forming part of the cost base and capital gains tax provisions must also be considered.

1. The provisions should not deny deductions for entities earning assessable income but are not carrying on a business

CPA Australia members have raised concerns that entities in certain situations will be denied deductions as they do not satisfy the requirements for 'carrying on a business' even though they are earning assessable income. The definition of 'carrying on a business' is described in TR 2019/1, specifically paragraph 29 which states: *"….profit-making activities, such as receiving rent from property, do not give rise to a presumption that an individual is carrying on a business, whereas it would if those same activities are undertaken by a company"*.

The issue is that taxpayers who are earning assessable income from the vacant land should be entitled to claim the associated deductions, rather than being forced to put them into the cost base. Where they do not satisfy the requirements of carrying on a business, this may result in property owners being denied most deductions, including positively geared properties. It would be more appropriate if non-commercial loss rules applied to such situations, rather than these provisions.

The following examples from members identify non-excepted entities (e.g. individuals) earning assessable income from vacant land, and who may be affected by this measure.

Example	Issues and factors for consideration
Agistment: A non-excepted entity owns vacant land and earns income from an agistment	• Due to the largely passive nature of the income earning activity, it is likely to be caught by the provision • If there is a substantial and permanent structure (SPS) on the land then could arguably be outside of the provisions. However, under the Explanatory Memorandum view, this is restricted to the area where the structure is situated • If land used by one of the acceptable 'related entities' in carrying on their business of farming then it may be excepted. Would not be excepted if leased to a third party

Example	Issues and factors for consideration
Car park: A non-excepted entity owns vacant land and allows cars to park on it in return for a fee	• Due to the largely passive nature of the income earning activity, it is likely to be caught by the provision. • Whether the entity is carrying on a business will be dependent on how much involvement it has in operating the car park. For example do they (or an employee) man the car park or is there just a ticket machine? • If there is a concrete surface, then this may constitute a 'structure'. If it covers 100 per cent of land, then it could be substantial and permanent in which case it would be excepted. • If not and people park on the grass, then this may prima facie be caught.
Farmland: A non-excepted entity owns farmland but has retired as a farmer. The farmer leases it to a third party	• May be caught. • The Explanatory Memorandum to the Bill states that past use of the land for business purposes can be sufficient to permit a continued deduction (paras 3.37 and 3.38). However, it is unclear as to the point at which that prior use becomes too remote. The example in the Explanatory Memorandum deals with the individual selling the land on cessation of the business and paying out the loan and interest. This is one extreme, compared to this example in which the land is rented out after the business has ceased. • If there is a substantial and permanent structure (SPS) on the land then could arguably be outside of the provisions. However, under the Explanatory Memorandum view, this is restricted to the area where the structure is situated.
Land lying fallow/ resting: A non-excepted entity owns farmland across two separate titles. Because of drought, it is not economical for the farmer to grow crops on one of the titles. As a result, the land lies vacant. The farmer continues some farming activities on the other title.	• May be caught. However, the provision only requires the land to be 'available for use' rather than used. If it is available (but just not profitable to farm), then arguably this should not be caught. • The Explanatory Memorandum states that future use of land in carrying on a business can be sufficient (para 3.31 and 3.32). It should be arguable that the business is continuing and the land continues to be used or held ready for use in that business. The individual is observing sound farming business practices by allowing some of the land to lie fallow.

For some taxpayers, the option to set up a company and lease the land from the individual may be available. The business could then be carried on through the company (e.g. running the car park). The company should likely constitute a business of a 'connected entity' under TR 2019/1 while the individual retains land in their own name and can apply the capital gains tax discount. However, the concern is that this may result in Part IVA considerations.

Consideration should be given to refining proposed subsection 26-102(2) to ensure non-excepted entities that earn assessable rental income but do not satisfy the requirements for carrying on a business are not denied deductions.

2. Costs denied on revenue account should be able to be claimed on capital account

A further concern is the potential for certain costs to be denied any tax recognition on capital or revenue account despite the comments in paragraphs 3.53-3.55 of the Explanatory Memorandum. These issues include:

- Costs relating to holding land are likely to be included in the third element of cost base but not included in the reduced cost base. Therefore, to the extent that the costs would create or increase a capital loss then they are permanently denied.
- Land becomes trading stock – where land is ventured into a development and begins to be held as trading stock, section 70-30 applies to deem the taxpayer to have sold and re-acquired trading stock for its cost (unless market value method is chosen whereby a gain may be crystallised). Interest and other holding costs are generally not considered as forming part of the cost of trading stock (see TD 92/132) and technically form

part of the CGT cost base. However, any capital gain or loss on the ultimate disposal is disregarded under section 118-25. Therefore denied deductions are not clawed back later by forming the cost of trading stock nor can they be claimed as part of a capital gains tax event.

- Land held on revenue account – Taxpayers who hold land on revenue account (i.e. for purpose of profit from an isolated transaction rather than in carrying on a business) currently may be able to deduct holding costs as they are incurred. If these deductions are now denied and instead form part of the CGT cost base, the anti-overlap rule in section 118-20 allows only the reduction of capital gains to zero and cannot create capital losses.

3. Broadening the scope of the proposed section 26-102(2) to include trusts

Trust operations may involve land leased by a trust to a related trust for use in carrying on a business. However, depending on the pattern of distributions or lack thereof, they may fail to satisfy the 'connected with' condition. They also cannot be affiliates. The provisions should be expanded to ensure that such trusts are not unfairly caught by the measure.

Schedule 4 – Extending anti-avoidance rules for circular trust distributions

CPA Australia supports the integrity provision.

Schedule 5 – Disclosure of business tax debts

The intent of the legislation is aligned with current policies to manage small business debts and address phoenix activities. However, CPA Australia remains concerned about potential issues with the administration of the disclosures. The proposal arguably extends the Commissioner's powers to disrupt a business beyond existing civil and criminal remedies.

CPA Australia is pleased to see that, following the consultation in 2018, the disclosure threshold has been increased to $100,000. However, there remains a distinct lack of clarity of how credit reporting bureaus (CRBs) will manage, use and be accountable for the information. The disclosure of business tax debts needs to be carefully administered to ensure that businesses are not unduly or unfairly impacted by the policy; and that credit reporting bureaus abide by the conditions required by the legislation and the ATO in handling and using the disclosures, and removing them when required.

CPA Australia submits the following identified issues, many of which were previously identified during the May 2018 Treasury consultation:

1. **CRBs that are not credit reporting bodies should be bound by the credit reporting body obligations.** Credit reporting bodies as defined in the *Privacy Act 1988* are subject to specific provisions in that Act as well as the *Privacy (Credit Reporting) Code 2014* (the *Code*). These obligations should be extended to CRBs that are not credit reporting bodies to ensure consistency across all recipients of tax debt information. Further, CRBs should be obligated to manage and use tax debt information of businesses in the same manner as for individuals, as defined in the *Privacy Act 1988* and the *Code.*
2. **Legally enforceable obligation to remove tax debt information by Credit Reporting Bureaus (CRBs).** To build confidence in the measure, approved CRBs must be required to expunge any tax debt information within a week of being instructed by the ATO to remove that information. The ATO administrative approach states that if an entity no longer meets the criteria for reporting, CRBs will be instructed to remove tax debt information within two business days of ATO notification, and to cease showing or using the data in an entity's credit report or credit history.

   While this addresses a key concern, no detail is given on the ATO's reporting terms or the penalties which will be imposed in the event of non-compliance. Compensation should also be made available to any affected

parties in the case of the misuse of information. Given the limited mandate of the Australian Information Commissioner over non-individual entities, the ATO should have the authority to audit CRB records to ensure information is handled correctly.

3. **Notice should be given of removal of information from CRB file.** Legislation should require that the ATO notifies the taxpayer when they have instructed the CRB to remove their tax debt information.

   A '*Notice of removal'* section should be inserted requiring:
   - The Commissioner to notify a primary entity when a credit reporting bureau has been directed to remove tax debt information from the primary entity's file, and
   - The notice must be in writing and served on the primary entity.

4. **Consider increasing the 90 day threshold to 120 days.** Due to the debt payment processes of many larger businesses, the 90 day threshold is a comparatively short period, especially for small businesses. Research by Xero shows almost half of invoices are paid late and many small businesses are paid 60 or more days after the invoice is issued. This has a significant effect on the ability to pay tax liabilities.

   The quarterly business activity statement (BAS) cycle means that, in effect, if a taxpayer has not paid their BAS liabilities or entered into a payment arrangement prior to the lodgment of the next BAS, the debt will be disclosed to the CRB. This may be a significant, albeit often intermittent, challenge for many small businesses.

   CPA Australia therefore suggests that consideration be given to raising the threshold to at least 120 days to reflect the reality of business finances, the business activity statement cycles and provide additional time to enter into payment arrangements with the ATO. Given the variety of situations which may give rise to tax debts and the potentially serious impacts on credit scores of those entities impacted, the ATO review process should include sign off by a senior ATO officer or a panel of senior officers.

5. **Safeguards should be put in place for entities that incur non-business related tax liabilities or who may have ABNs but are not running a business.** Unincorporated entities can incur tax liabilities associated with non-business activities such as from passive investments, trust distributions or capital gains, in addition to those generated by their business activities. To the extent that debts can be distinguished between business and non-business liabilities, only the business-related portion of overdue liabilities should be used to calculate the $100,000 threshold and be disclosed to CRBs. Alternatively, a threshold ratio could be considered to ensure that information is only disclosed where, for example, business-related tax debts exceed $100,000 and account for 80 per cent or more of total tax debts.

   CPA Australia also notes that the legislation may lead to an increase in predatory lending to businesses who wish to pay off tax debts to prevent disclosure to CRBs, especially where the ATO is unwilling to enter into a payment arrangement. This may compound, rather than resolve, small business liquidity challenges leading to a greater number of insolvencies than may otherwise be the case.

Schedule 6 – Electronic invoicing

No comment.

Schedule 7 – Salary sacrifice integrity

CPA Australia supports the provisions. However, we question the 1 July 2020 date of effect. Consideration should be given to an earlier start date to ensure that employees do not continue to be financially affected , especially given the two years that have elapsed since the Government's announcement.