The Tax Institute

13 September 2022

Director, Tax Administration Unit
Individuals and Indirect Tax Division
Treasury
Langton Crescent
PARKES ACT 2600

By email: taxadministrationconsultation@treasury.gov.au

Dear Director,

Proposed exclusions from shorter period of review for small and medium entities

The Tax Institute welcomes the opportunity to make a submission in relation to the exposure draft of the Income Tax Assessment (1936 Act) Amendment (Period of Review) Regulations 2022 (Cth) (**draft regulations**).

In the development of this submission, we have closely consulted with our National Small and Medium Enterprises and Large Business and Internationals Technical Committees to prepare a considered response which represents the views of the broader membership of The Tax Institute.

The changes made by the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* (Cth) to businesses with an aggregated turnover of less than $50 million were intended, in part, to simplify their reporting obligations and reduce the amount of red-tape to which these businesses were subject. Australia's tax system contains significant complexity and compliance costs for businesses and The Tax Institute is of the view that it is important to ensure that administrative burdens are not unreasonably increased.

Of particular concern, whilst the consultation for the draft regulations focuses on the consequences for the period of review for businesses, there may be consequences for individuals not in business. These implications, although briefly acknowledged in the explanatory materials, have not been made clear to the public and are likely not intended to fall within the scope of the draft regulations. We consider that the potential impacts on the period of review for individuals not in business is an unintended outcome that should be amended.

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We also consider it important for the draft regulations to achieve the appropriate balance between ensuring that taxpayers with complex or high-risk affairs are subject to the appropriate period of review and providing businesses with simpler tax affairs certainty of their tax obligations. Aspects of proposed exclusions encompass common or low-risk transactions, and may impact taxpayers who should retain the right to a shorter period of review. As currently drafted, the draft regulations may result the period of review for entities with simple tax affairs being inappropriately extended beyond a two-year period, contrary to intended scope of the legislation outlined above. There are also concerns that the proposed application date may result in inequitable outcomes due to its retrospectivity.

We would be pleased to continue to work with the Treasury on further development of the draft regulations to ensure that they achieve the appropriate policy outcome.

Our detailed response is contained in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more information about The Tax Institute.

If you would like to discuss any of the above, please contact our Tax Counsel, Julie Abdalla, on (02) 8223 0058.

Yours faithfully,

Jerome Tse

President

APPENDIX A

We have set out below our detailed comments and observations for your consideration.

Potential application to individuals not in business

We note that the many of the proposed exclusions will apply to item 1 in the table in subsection 170(1) if the *Income Tax Assessment Act 1936* (Cth). This could result in the proposed exclusions potentially applying to individuals who are not in business, provided any other relevant conditions were also met. We consider this to be an unintended outcome that should not fall within the scope of the draft regulations.

We note that Item 1 of the Table in Regulation 14 of the Income Tax Assessment (1936 Act) Regulation 2015 (Cth) (**ITAR 1936**) will currently apply to individuals not in business if:[1]

- there is a transaction involving associates that has 'income tax consequences';
- the parties were not dealing with each other at arm's length;
- one of the parties has a four-year period of review; and
- the transaction is relevant to an amount in the assessed entity's assessment.

Clause 1 of Schedule 1 of the draft regulations proposes to also exclude entities that enter into a transaction that 'relates to assets or non-cash-benefits that have a market value of $50,000 or more'. Further, Clause 2 of Schedule 1 of the draft regulations will repeal the current requirement for one the relevant entities to have a four year period of review. This may result in ordinary and low-risk transactions entered into by individuals not in business falling within the scope of the proposed exclusions.

By way of example, an individual entering into an arrangement with their direct family member, qualified and operating in a relevant trade, to conduct improvements on an investment property at arm's length prices will likely have satisfied the requirements above. This is because the individual will have entered into a transaction with an income tax consequence for an asset that 'relates to' an asset worth more than $50,000. We are of the opinion this will likely be the case if the same arrangement took place on the individual's main residence, even though the gain on disposal would not otherwise be included in the assessable income, as the increase in the cost base of the property will likely be an 'income tax consequence'. We note the concerns associated with the term 'relates to' below. As a result, the individual who is not in business may be subject to a longer period of review.

We consider this to be an inappropriate and unintended outcome. We note that the explanatory material to the draft regulations state:[2]

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1 Column 2 of Item 1 of the table in regulation 14 of the ITAR 1936.

2 Explanatory materials to the draft regulations, page 1.

> 'The *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* increased access to several small business entity tax concessions by expanding eligibility to include medium business entities (entities with an aggregated turnover of $10 million or more and less than $50 million). This enabled medium business entities to access some concessions that were previously only available to small business entities, including a shortened period of review of two years instead of four years. However, the shortened period of review is not appropriate for entities with complex affairs or significant international tax dealings, and therefore will continue to have a four-year amendment period.
>
> The Amending Regulations amend section 14 of the Regulations to exclude certain entities with particularly complex tax affairs or significant international tax dealings from a two-year period of review.'

However, the explanatory materials later state:[3]

> Schedule 1 – Amendments to the *Income Tax Assessment (1936 Act) Regulation 2015*.
>
> Section 14 of the *Income Tax Assessment (1936 Act) Regulation 2015* (the Regulations) prescribes a number of scenarios that result in an entity that is an individual, a company that is a small or medium business entity or a person acting in the capacity of a trustee of a trust that is a small or medium business entity (the assessed entity) being excluded from the shortened two-year period of review. Where an entity is excluded from the two-year period of review, the Commissioner is permitted to amend an assessment of the relevant entity within the standard four years after the day on which the Commissioner gives notice of the assessment to the entity, unless a longer amendment period applies.
>
> Section 14 of the Regulations is amended to exclude relevant assessed entities with particularly complex tax affairs or significant international tax dealings from accessing the shortened two-year period of review and instead subjects impacted entities to the standard four-year period of review.

The explanatory materials to the draft regulations state what regulation 14 of the ITAR 1936 provides for. However, having regard to the context in which they are introduced, and balance of explanatory materials, we consider that the draft regulations are not intended to apply to 'individuals not in business'. The Tax Institute is of the view that amendments to the draft regulations should be made to remove any consequences to the period of review for individuals not in business. If Government does intend for all individuals to be captured by these amendments, this intention should be clearly stated and publicly communicated.

Related party dealings

Clause 1 of Schedule 1 of the draft regulations proposes to exclude from the two-year period of review entities that enter into a transaction that 'relates to assets or non-cash-benefits that have a market value of $50,000 or more'. We are concerned that the current wording and prescribed threshold may create uncertainty and is likely to capture taxpayers with simple affairs, going beyond the intended application of the draft regulations.

[3] Explanatory materials to the draft regulations, page 2.

We consider that the use of the phrase 'relates to' is too broad in scope and may unintentionally capture low value and risk transactions. By way of example, it is reasonably arguable that a transaction concerning deductions to the value of $3,000 for a property worth $750,000 could fall within the scope the proposed exclusion. We also note that the proposed threshold of an asset value of $50,000 is likely to impact the transactions undertaken by a large portion of all small and medium entities (**SMEs**). This will likely result in most SMEs being subject to a four-year period of review in most years, even where they have simple tax affairs. We consider this to be unreasonable outcome which is not consistent with the underlying policy objective.

The Tax Institute is of the view that this proposed exclusion should be amended to ensure that it better targets businesses with complex or high-risk tax affairs. This may be achieved by qualifying the phrase 'relates to' with a reasonable and readily identifiable limit, and increasing the current $50,000 threshold amount. We recommend that the current wording be replaced with:

> the transaction has a market value of $50,000 or more and relates to an asset or non-cash benefit worth $500,000 or more.

Foreign sourced income

Clause 3 of Schedule 1 of the draft regulations broadly seeks to exclude entities that derive at least $200,000 in assessable income from non-Australian sources from the two-year period of review. Again, we note this expands the amended circumstances applicable to individuals not in business under Item 5 of the table in Regulation 14 of ITAR 1936 to an extent outside of the intention stated within the explanatory materials. Further, we consider that the current threshold is likely to capture a significant number of SMEs that undertake low-risk activities, such as exporters that undertake moderate value but low-risk transactions.

As it pertains to individuals, we consider that the proposed exclusion should be limited to individuals in business. Furthermore, it should be replaced with transactions or activities that require a longer period of time to identify or are of higher risk. In the alternative, acknowledging the potential difficulties in formulating an exception that is readily identifiable, the current threshold could be increased. A threshold of, for example, $2 million is likely to achieve a more appropriate balance between ensuring high-risk activities and complex structures are subject to a longer period of review, without impacting businesses with simple tax affairs.

Foreign entities

Clause 3 of Schedule 1 of the draft regulations also proposes to exclude foreign controlled entities from the two-year period of review. Reviewing the affairs of large and complicated structures spanning multiple overseas jurisdictions can be complex. Feedback from our members suggests that it is not uncommon for foreign controlled entities to engage in transactions of an immaterial amount, or operate independently of the foreign parent in Australia. We consider that this proposed exclusion should be refined to refer to specific risks or activities of concern. For example, it may be more appropriate to only subject foreign controlled entities that engage in transactions that enliven the operation of Division 820 of the *Income Tax Assessment Act 1997* (Cth) to a longer period of review.

‘Connected with’ exclusion

Clause 6 of Schedule 1 of the draft regulations proposes to exclude ‘assessed entities’ that have at least 10 other entities that are affiliates of, or connected with, them from the two-year period of review. Feedback from our members indicates that this proposed exclusion may be unreasonably broad. Currently, the proposed exclusion may capture SME groups with low value and low risk transactions. By way of example, this could include a family owned and operated business where the family members also have their own separate investment vehicles undertaking unrelated transactions.

The ‘assessed entity’s’ aggregated turnover is considered as a pre-requisite to determining whether they are eligible for a shorter period of review. Dealings that are undertaken on a non-arm’s length basis will also cause entities to be excluded from the two-year period of review. As a result, this proposed exclusion may not be needed to target high risk activities or complex structures. If retained, we consider that it should be refined to refer to specific risks or activities of concern. If it is not possible to identify the risk, we recommend that a higher threshold is utilised that is more likely to only identify high risk groups or complex dealings.

Application date

The draft regulations state that the proposed exclusions will apply in relation to an assessment for an income year if:

- the assessment is made after the commencement of that Schedule; and
- the income year begins on or after 1 July 2021.

This means that it will apply retrospectively to previous income years beginning on or after 1 July 2021. The proposed application date may also give rise to some complexity and inconsistent treatment depending on when the relevant taxpayer has lodged their tax return. The proposed application date may result in some taxpayers being subject to a shorter period of review if they have lodged their tax return before the commencement of the draft regulations. Conversely, a taxpayer with substantially the same or simpler tax affairs may be subject to a four-year period of review, as a result of the broad nature of the proposed exclusions, as they lodged their tax return after the commencement of the draft regulations. This is likely to result in significant confusion for taxpayers and tax professionals in practice.

The Tax Institute is of the view that the draft regulations should take effect at the same time for all taxpayers for income years beginning on or after 1 July 2022. This will ensure clarity for taxpayers and remove the potential confusion outlined above.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.