

20 April 2023

The Honourable Dr Jim Chalmers MP Treasurer  
Parliament House Canberra ACT 2600

Dear Treasurer,  
2023-24 pre-budget submission  
Income tax matters

The Institute of Financial Professionals Australia is a not-for-profit membership association (originally known as Taxpayers Australia, then more recently Tax & Super Australia) and has been serving members for over 100 years. With a membership and subscriber base of over 15,000 practitioners, our association is at the forefront of educating and advocating on behalf of independent tax, superannuation and financial services professionals. Our members have an ongoing interest in the effective functioning of Australia's tax system and this pre-budget submission by the Institute reflects those interests.

This submission should be read in conjunction with the Institute's earlier submission in relation to superannuation matters.

### **A conversation about tax reform**

The main focus of the 2023-24 Budget should be on how best to position Australia's tax system for the 21<sup>st</sup> century. Further enhancing tax integrity around multi-national entities and the recently announced changes to the rules for taxing larger superannuation balances fall well short of comprehensive tax reform and in spite of some good fortune in relation to commodity prices remaining buoyant for longer than expected and the additional company tax that generates, there are inexorable pressures on the outlays side, including from defence, the NDIS, aged care and debt servicing.

Shortly stated, Australia's tax system does not generate sufficient revenue to fund our spending decisions, leaving the Budget in a serious structural deficit. There are also concerns, again raised recently by the IMF, that Australia places undue reliance on direct taxes such as personal and company income tax.

There have been numerous reviews of Australia's tax system in the past, most of which have been compromised from the outset or soon after by particular policy issues being

ruled out. At a broad level, these reviews show the way forward, but governments have lacked the political wherewithal to make tax reform happen.

Convincing the community about the need for reform is always challenging, given that there are always winners and losers in the reform process. With the current focus that many Australia families have on cost of living issues, however, there may in fact be a better appreciation in the community of the need to make ends meet in a public finance perspective and also to move to a tax system that is more efficient and less distortive. This will require a conversation with the Australian people.

The Institute would strongly support a “no holds barred” review of our tax and transfer system, although it goes without saying that spending decisions should always be carefully scrutinised to ensure that outlays represent value for money.

The following specific tax issues are raised for your consideration, either in the upcoming Budget or beyond:

### **Trust distributions and uncertainty around s 100A**

While s 100A may, on its face, apply to circumstances where unclaimed present entitlements are accumulated in a family trust or made available to associates, we consider such an outcome is inconsistent with the mischief this provision was designed to prevent, which was the insertion of low tax or tax-free beneficiaries. We note this provision was introduced at the height of the tax avoidance era and before the introduction of Part IVA in 1981.

The finalised guidance material released by the ATO in December 2022 has the potential to disturb distribution practices followed by many thousands of Australian family businesses for decades. In particular, the ATO guidance inappropriately reads down the observations made by Logan J at first instance in the *Guardian case*. In that decision His Honour held that the ordinary family dealing exception applies unless the arrangement includes features of artificiality.

While the Full Federal Court has since handed down its appeal decision in *Guardian*, clarifying aspects of s 100A and Part IVA, the judgment does nothing to shed light on the scope of the ordinary family or commercial dealing exception.

The Institute submits the government should consider the following options:

1. Repeal s 100A on the basis that Part IVA makes it redundant (as demonstrated in the Full Court’s decision in *Guardian*).
2. Amend s 100A to deem the application of funds arising from distributions made to members of a family group as defined in s 272-90 *ITAA 1936* as automatically falling within the ordinary family dealing exemption.

## Taxation of Trusts

Aside from the specific s 100A issue highlighted above, the taxation of trusts in accordance with respective provisions contained at Divisions 6 and 6E *ITAA 1936* and s 115C *ITAA 1997*, has been a particularly difficult and challenging part of the taxation regime for tax practitioners, the ATO and for taxpayers.

These difficulties and challenges in administering the taxation of trusts arise, in general, due to the complexity of interpreting the 'flow through' concepts inherent in the legislative framework (e.g. the concept of present entitlement, the differences in understanding trust law concepts and tax concepts, the economic differences that arise where distributable income does not flow to a beneficiary in receipt of the taxation distribution).

In light of the foregoing, we recommend that the government reconsider the proposal raised by Treasury in its reform paper: *Modernising the Taxation of Trust Income – Options for reform November 2011*.

In that paper Treasury proposed three alternative models for reform:

- The Patch Model
- The Proportionate within class model, and
- The Trustee Tax and Deduction Model (TAD model).

Whilst each of the options have their merits in terms of improving the law, we consider that the proposal contained at Section 8.3 of the Treasury paper in respect of the TAD model, if adopted, could overcome many of the difficulties for tax practitioners and taxpayers in administering their compliance obligations under the trust taxation regime.

The TAD model was renamed the 'economic benefits model' (EBM) and subject to further analysis in Treasury's *Policy Options paper*, released in October 2012. Since that time, however, there appears to have been little or no progress on the issue.

We recommend that the government consider the foregoing in relation to the taxation of trusts to improve the taxation and economic outcomes for taxpayers and the improved administrative efficiency of tax practitioners.

## Division 7A

Tax practitioners and their private company clients continue to await progress on simplification reforms to Division 7A *ITAA 1936* as first announced by the previous government almost seven years ago.

Changes announced in the 2016-17 budget drew on a number of recommendations from the Board of Taxation's Post Implementation Review of Division 7A, and included:

- a self-correction mechanism to assist taxpayers to rectify inadvertent breaches of Division 7A promptly.
- appropriate safe harbour rules to provide certainty and simplify compliance for taxpayers.
- simplified rules regarding complying Division 7A loans, including in relation to loan duration and the minimum interest rate.
- a number of technical amendments to improve the integrity and operation of Division 7A and provide increased certainty for taxpayers.

In the 2018-19 budget, the former government announced two further changes:

- for all unpaid present entitlements to come within the scope of Division 7A.
- a deferral of the start date of the 2016-17 announcements.

The ongoing delays in the simplification of Division 7A have resulted in increased complexity, compliance costs and uncertainty for tax practitioners and their small to medium business clients. We urge the government to clarify its position, specifically whether, when and how the previously announced changes will proceed.

### **Small business restructuring roll-over rules**

With the ATO's increasing focus on trusts and trust distributions, we are aware that some family businesses may be weighing up the merits of adopting a corporate structure instead, which brings the small business restructuring roll-over rules in Subdiv 328-G *ITAA 1997* into sharper focus. Practitioners are concerned about the uncertainty around what represents a genuine restructure (in spite of the existence of a safe harbour), while the requirement to maintain the same underlying economic ownership in the assets of the business is not one that is easily satisfied in the case of discretionary trusts.

Subject to what emerges from the Board of Taxation's systemic review of the CGT roll-over rules (see below), the Institute suggests a specific review of the small business restructuring roll-over rules should be undertaken with the view of identifying and removing impediments and increasing certainty in relation to genuine small business restructures.

## Residency rules for individuals

As part of the May 2021 federal Budget, the then government announced that it would adopt the recommendations of the Board of Taxation contained in its December 2019 report '[Reforming Individual Tax Residency Rules – a model for modernisation](#)'. The Board put forward a two-step framework that relies primarily on a 183-day bright line test. For the vast majority of individuals, this test will likely negate the difficulty in interpreting the current subjective consideration of the residency question.

The Board's proposals represent a significant improvement over the current position, and we encourage the government to review the position and enact legislation within the shortest practicable timeframe.

## CGT roll-overs

The Board of Taxation was requested to identify and evaluate opportunities to rationalise the existing CGT rollovers and associated provisions into a simplified set of rules that have a substantially similar practical effect but are easier to use and interpret. We understand the Board has provided interim written advice to the previous government in March 2021.

We would like the government to release the Board's report and engage with the tax profession about the next steps in this area.

## Luxury car tax

With the local manufacture of motor vehicles coming to an end some years ago, it is difficult to justify the continued imposition of the luxury car tax (LCT).

The LCT is, in our submission, a clumsy and arbitrary proxy for luxury which fails to promote vertical or horizontal equity. We do not impose a luxury tax on diamonds, fur coats or yachts, so why tax moderately expensive cars?

Australia's robust progressive income tax system, coupled with its largely means-tested transfer system, is a much more effective and comprehensive way of redistributing income.

Short of its abolition (or phasing out), the LCT threshold should be significantly increased. The LCT today applies to far more vehicles than it did when it was first introduced. Increasing the threshold to around \$100,000 would mean that it applies to cars that most fair-minded people would regard as luxury vehicles.

### **Car depreciation limit**

As is the case with the LCT, the car depreciation limit has not kept up with automotive industry changes and today applies to far more vehicles than it did on its introduction. While the Institute has no objection in principle to having some sort of cap on business depreciation for cars, we consider the threshold should be raised to somewhere around \$100,000 and more appropriately indexed thereafter.

### **Deductibility of work related expenses**

The legal basis for employees that are not in business claiming deductions for work related expenses should be reviewed in light of recent societal changes following the widespread adoption of remote working practices triggered by the COVID pandemic.

The principles around deductibility were established in an era when the vast majority of taxpayers held a single employment position and travelled between home and work twice a day. It is questionable whether those principles remain appropriate in today's gig economy, where taxpayers hold down two or more jobs and rarely report to a place of employment for any of them.

While the ATO has partially filled the gap with some administrative safe harbours in relation to working from home expenses, it is time to revisit the area of working from home and travelling between jobs in a post COVID environment.

### **GST registration threshold for not for profits**

The GST registration threshold for not for profits has been set at \$150,000 for a number of years now. While this is double the registration threshold for ordinary businesses, \$150,000 is, in our submission, a relatively low threshold. Singapore, for example, has a threshold of SGD \$1 million (AUD \$1,120,000).

To avoid NFPs incurring compliance costs on exceeding the current low threshold, it may be time to review the settings and significantly raise the threshold – we would suggest at least doubling it to \$300,000. This would help charities and other NFPs focus more on pursuing their core mission rather than chasing down relatively trivial GST debits and credits.

### **GST grouping provisions**

Consideration should be given to expanding the GST grouping provisions to extend grouping to trusts sharing the same Family Trust Election test individual. This will help minimise the negative cashflow impact that is currently experienced in relation to related party transactions involving such entities.

### **Small business entity thresholds**

We have identified a dozen small business concessions which between them have turnover thresholds of \$2million, \$5 million, \$10 million and \$50 million. These differing thresholds for the same concept are apt to cause confusion, sometimes even among tax practitioners. While we appreciate there may have been revenue considerations that were considered in setting the various thresholds at different times, the distinctions seem rather arbitrary and they add unnecessary complexity. The small business thresholds should be reviewed with the aim of standardising them as much as possible.

### **Instant asset write-off**

Absent any legislative intervention, temporary full expensing (TFE) will come to an end on 30 June 2023, while the instant asset write-off threshold reverts to \$1,000. While the Institute is not advocating a further extension to the TFE concession, which was available to all but the largest of businesses, we are hearing about concerns that small businesses will experience serious cash-flow problems without some sort of alternative incentive to invest in capital equipment going forward.

Many of these smaller businesses are still finding their feet after the impact of COVID-19 and are currently struggling to cope with much higher interest rates as well as spiralling energy costs.

Resetting the instant asset write-off threshold would be the best way of addressing this issue. We would recommend a threshold of \$100,000 for businesses with an annual turnover of up to \$50 million, effective from 1 July 2023.

### **Trading stock simplification for small business**

Rather than spend time counting and recording stocks of fruit and vegetables, potato cakes and other low value perishable items, small businesses should be able to opt out of the requirement to account for movements in trading stock items with a shelf life of three months or less. This compliance saving would be in addition to the existing \$5,000 estimated annual stock movement concession in s 328-285 *ITAA 1997*.

### **Annual leave and long service leave provisions**

Subject to a cap, small businesses should be entitled to a deduction for annual leave and long service leave provisions where the employee has a legal entitlement to the accrued amount, rather than when the relevant leave is taken. This would provide a welcome cashflow benefit to those small businesses and could be subject to a limit of, say, \$50,000.

### **Interest income inflation adjustment**

Interest rates on deposits offered by the major banks are hardly generous, but taxing nominal interest income when real returns for investors are negative is adding insult to injury. With the rate of inflation expected to remain elevated for some time to come, consideration should be given to providing limited relief to some investors. This issue affects all depositors but is especially harsh on self-funded retirees and younger Australians saving for a home deposit.

The Institute proposes a 50 per cent discount on assessable interest income of up to \$1,000 (i.e. a maximum discount of \$500) for individual taxpayers having a taxable income below, say, \$200,000 in any year of income when the official annual rate of inflation exceeds 4 per cent.

### **Revitalising the Central Business District**

The pandemic has created what is probably a permanent shift in Australian working arrangements, with many employees, with the consent of their employers, working from home for at least part of the week. This has had a sustained negative impact on many businesses operating in our CBDs, particularly those involved in the hospitality industry.

Consideration should be given to suspending the non-deductible entertainment rules for both income tax and FBT in relation to meals entertainment that takes place within the confines of the CBD.

If you have any questions in relation to this submission, please contact Frank Drenth on 0412 444 975 or [f.drenth@ifpa.com.au](mailto:f.drenth@ifpa.com.au)

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Terry Blenkinsop', written over a light blue horizontal line.

Terry Blenkinsop

Director