AUSTRALASIAN
TAX TEACHERS ASSOCIATION

JOURNAL OF THE AUSTRALASIAN TAX TEACHERS ASSOCIATION

2012
Vol.7 No.1

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The Journal of the Australasian Tax Teachers Association ('JATTA') is a double blind, peer reviewed journal. The Journal is normally published annually, subsequent to the Association's annual conference.

The Australasian Tax Teachers Association ('ATTA') is a non-profit organisation established in 1987 with the goal of improving the standard of tax teaching in educational institutions across Australasia. Our members include tax academics, writers, and administrators from Australia and New Zealand. For more information about ATTA refer to our website (hosted by ATAX at the University of New South Wales) at http://www.asb.unsw.edu.au/schools/taxationandbusinesslaw/atta.

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ISSN: 1832-911X

Volume 7 Number 1 published November 2012

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POST IMPLEMENTATION REVIEWS OF RECENT AUSTRALIAN TAX REFORM

PAUL KENNY*

ABSTRACT

This paper examines the post implementation review stage of the enacted tax reforms: the non-commercial loss ('NCL') and Simplified Tax System ('STS'), that flowed from the recommendations of the 1999 *Review of Business Taxation.* 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 have gained assent into law. The NCL and STS reforms provide particularly good examples to assess the post implementation review processes, given the significant flaws inherent in the legislation. This paper finds that the post implementation review processes for the NCL and STS were narrowly based, ad hoc, and/or untimely. Such enacted tax reforms need to be subject to a timely and thorough post implementation review process by an independent body. An effective post implementation review process also requires extensive consultation and should be ongoing.

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I INTRODUCTION

This article critiques the post implementation review stage,[1] and the operation of the Board of Taxation, in respect of the enacted 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 have gained assent into law.[3] Having regard to the enormity of the *Ralph Review* tax reform legislation, this article employs a partial analysis that focuses on the post implementation review processes in respect of two significant reforms, the non-commercial loss rules ('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 business loss deductions where the business is operated by a natural person. The exemptions in these rules, however, greatly stymied its effectiveness. Whilst the STS was a tax expenditure aimed at helping small business, it proved to be impractical. Numerous changes were made to the STS before it was abolished as a system.

This article commences by detailing the federal government's post implementation reviews processes for the *Ralph Review* reforms. The article then provides an overview

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1 Australian tax reform generally follows a three stage process involving policy formulation, legislation design, and post implementation reviews. This article is the third in a series of three articles 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 article, 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 P Kenny '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 article 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 P Kenny, (2010) 'Legislative design and tax reform: The weakest link?', 25(2) *Australian Tax Forum* 179.

2 *A Tax System Redesigned*, above n 1. The Report was the last in a series of four papers published by the Review of Business Taxation.

3 Michael Dirkis and Antony Ting, 'Cataloguing Business Tax Reform Seven Years On' (2006) 21 *Australian Tax Forum* 601 notes that the Government introduced 144 taxation bills between June 1999 and October 2001: 44 taxation and superannuation related bills in 2002; 20 in 2003; 46 in 2004; 22 in 2005; and 14 by 14 September 2006.

4 *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) div 35.

5 ITAA 1997 div 328 and *Income Tax Assessment Act 1936* (Cth) (ITAA 1936) s 82KZM. 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.*

of the NCL and STS regimes before analysing the associated post implementation review processes.

The article finds that post implementation review processes for the NCL regime and STS were narrowly based, ad hoc, and/or untimely. Whilst the *Board of Taxation* carried out certain post implementation reviews, these processes were stymied by restrictive terms of reference and what appears to be inadequate funding. Such enacted tax reforms need to be subject to a timely and thorough post implementation review process by an appropriately funded 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.

II THE RALPH REVIEW POST IMPLEMENTATION REVIEW PROCESSES

A *The "Proposed" Board of Taxation*

Originally, the *Ralph Review* proposed the establishment of an advisory Board of Taxation (herein after known as the '*proposed Board*') with seemingly wide ranging powers to review tax legislation.[7] The *proposed Board* was to review the ongoing development of the business tax system against the national taxation objectives that were to be set out in a proposed *Charter of Business Taxation*.[8] This would overcome the concern in relation to the 'largely piecemeal approach which has evolved in relation to the development of business taxation policy…'.[9] The functions to be undertaken by the *proposed Board* would include the following functions:[10]

- 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;

[6] Economic efficiency, equity, simplicity, and fiscal adequacy. See James Alm, 'What is an "Optimal" Tax?' (1996) XLIX *National Tax Journal* 117, 117.
[7] *A Tax System Redesigned,* above n 1, 102–03.
[8] Ibid: '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 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 will have the role of monitoring compliance with these objectives.'
[9] Ibid 119.
[10] Ibid.

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 rejected the proposed Charter. [11]

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.'[12] Thus, in August 2000, the federal government established the *Board of Taxation* (hereinafter known as the 'Board') under a different model.[13] The Board was to advise on the development and implementation of taxation legislation as well as the ongoing operation of the tax system.[14] The Board would also ensure that there would be full and effective community consultation in the design and implementation of tax legislation.[15]

B *The Board of Taxation Reviews*

In May 2002, the Treasurer announced an expanded role for the Board that would see it consistently 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'.[16] Since that time the Board has been directed on an ad hoc basis to conduct post-implementation reviews of tax legislation. Over twelve years the Board has only reviewed five [17] of the many enacted *Ralph Review* reforms (including the NCL rules discussed in this article).

C *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).[18]

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[11] Peter Costello, Treasurer, 'The New Business Tax System' (Press Release No 56 of 21 September 1999).
[12] Ibid.
[13] Peter Costello, Treasurer, 'Board of Taxation: Membership' (Press Release No 83 of 10 August 2000).
[14] Ibid.
[15] Ibid.
[16] Peter Costello, Treasurer, 'Reforms to Community Consultation Processes and Agency Accountabilities in Tax Design' (Press Release No 22 of 2 May 2002).
[17] Non-Commercial loss legislation contained in ITAA 1997 div 35; Alienation of personal services income rules — ITAA 1997 Divs 84–87; the small business capital gains tax concessions — ITAA 1997 div 152; and certain aspects of the consolidation regime — *Income Tax Assessment Act 1936* (ITAA 1936) pt III Div 7A.
[18] Gary Banks (Chairman), *Taskforce on Reducing the Regulatory Burden on Business Rethinking Regulation,* 31 January 2006, <http://www.regulationtaskforce.gov.au/finalreport/>.

III POST IMPLEMENTATION REVIEWS OF THE NCL RULES

A *Overview of the Non-Commercial Loss Legislation*

The NCL legislation contained in div 35 of the *Income Tax Assessment Act 1997* ('ITAA 1997')[19] applies from 1 July 2000 to each and every income year in which an individual[20] taxpayer (whether alone or in a general law partnership)[21] is carrying on[22] a relevant business activity. Division 35 works to quarantine certain losses[23] 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 Commissioner's discretions). If none of these exceptions applies, the loss is quarantined and can only be offset against future profits from the same business activity.[24] This carries the loss forward to the next income year or beyond.

The NCL limitations do not apply if the business activity is a 'primary production business' and the taxpayer's assessable income (excluding net capital gains)[25] from other sources that do not relate to that activity is less than $40,000.[26] 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.[27]

The assessable income test is the first of the four objective tests and 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 relevant business activity for the year is at least $20,000.[28] The profits test[29] 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 relevant business activity makes taxable income.[30] Under

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[19] 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 ITAA 1997 s 35-55(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 but this was replaced by a more restrictive test based on $20,000 of assessable income in s 35-30.

[20] An 'individual' means a natural person: Australian Taxation Office (ATO), *Income Tax: Division 35 — Non-commercial business losses*, TR 2001/14, 19 December 2001 [34] and ITAA 1997 s 995-1(1) (definition of 'individual').

[21] ATO, *Income tax: whether business is carried on in partnership (including 'husband and wife' partnerships) as to what constitutes a 'general law partnership*, TR 94/8, 27 January 1994.

[22] 'Carrying on' is defined in ITAA 1997 s 995-1 as 'carrying on an enterprise includes doing anything in the course of the commencement or termination of the enterprise.'

[23] ITAA 1997 s 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.

[24] ITAA 1997 s 35-10(1), (2).

[25] 'Net capital gain' is defined in s 995-1 as having the meaning given by ss 102-5 and 165-111.

[26] ITAA 1997 s 35-10(4).

[27] ITAA 1997 s 35-10(4).

[28] ITAA 1997 s 35-30.

[29] ITAA 1997 s 35-35.

[30] Assessable income from the activity exceeds deductions, ITAA 1997 s 35-35(1). The profits test ignores any NCL carried forward losses.

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.[31] 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 are used on a continuing basis in carrying on the activity in the year, is at least $100,000.[32] Additionally, the Commissioner may exercise his discretion not to apply the loss deferral rule to a business activity for one or more years for businesses that have special circumstances[33] or lead times.[34]

B *Rationale and Reality*

The tax policy rationale for the NCL rules was 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.[35] 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.[36] The revenue forecast provided for small savings in tax revenue[37] and indicated no clear gain or loss to simplicity.[38]

However, commentators and professional and government bodies found that the NCL regime breached the tax policy criteria.[39] The various NCL exemptions enable many

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[31] ITAA 1997 s 35-40.

[32] ITAA 1997 s 35-45(1).

[33] 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, ITAA 1997 s 35-55(1)(a). The special circumstances include drought, flood, bushfire or some other natural disaster, ITAA 1997 s 35-55(1)(a).

[34] This discretion has the following three requirements. First, an individual must have started to carry on a business activity. Second, the business activity must, because of its nature, fail to satisfy one of the four tests set out above in ITAA 1997 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.

[35] Explanatory Memorandum, New Business Tax System (Integrity Measures) Bill 2000, [1.7]–[1.9].

[36] Ibid [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'.

[37] Ibid, General outline and financial impact. The EM forecast a gain to revenue of $140 million in 2003–04.

[38] Ibid [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 would provide a more consistent and easily understood business tax system. There might be an increase in compliance costs for some taxpayers but this would be 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.

[39] For example see: L Samarkovski and B Freudenberg, '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; P Kenny, 'The Non Commercial Loss Restrictions: A Very Blunt Instrument for Micro Business' (2006) 21 *Australian Tax Forum* 573; L Greenleaf, '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

Footnote continues over page

hobby/lifestyle activities to sidestep the loss limitation rules.[40] 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.[41] These exemptions are inconsistent with the equity and the fiscal adequacy criterion. This is also economically inefficient since exempting such hobby/lifestyle activities encourages inefficient use of scarce resources.[42]

On the other hand, these tests have an onerous effect in preventing losses for genuine businesses, given that over 100,000 individuals are subject to the NCL limitations.[43] Additionally, div 35 failed to replace and simplify existing tax legislation.[44] Rather, these rules added another layer of complexity.

C *NCL Post-implementation Review*

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 to determine whether div 35:[45]

- 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.

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*'; R Douglas, 'Farmers Nil, Commissioner Nil. Thanks, Ralph Great Result' (2001) 35 *Taxation in Australia* 387; G Cooper, 'Tax Reform: Non Commercial Losses' (2000) 35 *Taxation in Australia* 160.

[40] Kenny, above n 39, 595–98; Greenleaf, above n 39, 681; Douglas, above n 39, 390–92; Cooper, above n 39, 163.

[41] Ibid.

[42] Rural Industries Research and Development Corporation, above n 39, vi; Submissions to the Board of Taxation's Post-implementation Review, Taxpayers Australia, above n 39.

[43] Board of Taxation, *Quality and Effectiveness of the Non-Commercial Losses Legislation — Post-implementation Review* (2004) [1.13]–[1.14], <http://www.taxboard.gov.au/content/CompletedReviewsAndConsultations.aspx>.

[44] For example, under these rules the issue of whether a business is being carried on, a major area of uncertainty, still needs to be resolved.

[45] Board of Taxation, Post-implementation Review, above n 39, [1.2].

From the outset, the Board appears to have adopted a very limited review of div 35, as it stated in its report: [46]

> [P]ost-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.*[47] Further, the *Ralph Review* considered the *proposed Board's* role should have been to be the guardian of the *Charter of Business Taxation* (as discussed previously)[48] if it is to consider the tax objectives and tax design principles.

It is also apparent that the Board's consultation process was constrained, as the Board only received 24 public submissions despite the 100,000 plus taxpayers having deferred losses under div 35.[49] 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[50] and the way the rules defer deductions for genuine business losses.[51] The submissions also pointed to the complexity of the NCL rules.[52] The Board, though, declined to respond directly to these concerns because it had excluded policy issues from the scope of its examination.[53] This is considered to be a weakness in the Board's mandated review process and inconsistent with the *Ralph Review's* recommendation.[54]

The Board[55] observed that the business and industry submissions to its examination,[56] and the BDO Kendalls' survey results,[57] 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 as to what types of businesses could be

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[46] Ibid [1.3].
[47] *A Tax System Redesigned,* above n 1, 102–03.
[48] Ibid 119.
[49] Board of Taxation, Post-implementation Review, [1.13]–[1.14], <http://www.taxboard.gov.au/content/CompletedReviewsAndConsultations.aspx>.
[50] Taxation Institute of Australia, Submission to the Board of Taxation Post-implementation Review, above n 39, 2; Taxpayers Australia, Submission to the Board of Taxation Post-implementation Review, above n 39, 6.
[51] Taxation Institute of Australia, Submission to the Board of Taxation Post-implementation Review, above n 39, 1.
[52] Ibid, 5. Institute of Chartered Accountants, Submission to the Board of Taxation Post-implementation Review, above n 39, 2–5.
[53] Board of Taxation, Post-implementation Review, above n 43, [1.15]–[1.17].
[54] As noted above, this is out of step with the *Ralph Review's* view of the post implementation process, see *A Tax System Redesigned,* above n 1, 17.
[55] Ibid 1.19.
[56] Board of Taxation Post-implementation Review, Submissions Received, above n 39.
[57] Board of Taxation Post-implementation Review, BDO Kendall Report, above n 43.

grouped and what sorts of activities constituted a professional arts business.[58] Further, they uncovered an anomaly, namely provisions failed to take into account the value of depreciated plant for taxpayers in the STS/SBE regimes.[59] Nevertheless, the Board concluded:[60]

> 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.

The Board made the following five recommendations, designed to alleviate the concerns raised in the consultation phase:[61]

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. 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 and div 328.[62] However, this

[58] Ibid. For example what constitutes a professional arts business was in dispute in *Pedley v Federal Commissioner of Taxation* AATA 108; 2006 ATC 2064; (2006) 62 ATR 1014. In this case the AAT held that the taxpayer was engaged in an installation arts business.
[59] Board of Taxation Post-implementation Review, above n 43, [1.19].
[60] Ibid [1.18].
[61] Board of Taxation 'Post-implementation Review of the Non-commercial Losses Legislation' (Press Release No. 14, 27 April 2005) 4, <http://www.taxboard.gov.au/content/Content.aspx?doc=publications_and_media/media_releases/014.htm&pageid=008>
[62] Ibid.

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 with the *Ralph Review's* recommendation for an integrated tax code.[64]

Whilst the Board asserted that the NCL provisions improve simplicity and reduce uncertainty,[65] the analysis of commentators and 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 and resources to review the effectiveness of the reforms against their policy objectives and the four key tax policy criteria.

2 *Ad hoc Amendment 2002: Amendment to the Commissioners discretion*

Division 35 was amended in 2002 to correct a technical defect under s 35-55(2). Previously, s 35-55(2) prevented the exercise of the Commissioner's discretion after the first occasion on which the business activity produced a profit or met one of the tests, even for earlier income years, even though the period that was commercially viable was still in course.[66] Thus, the discretion could not be exercised in income years in which losses arose 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 *Consequential Amendment 2006: Business Related Costs*

In 2006 the government introduced a provision to broaden the operation of 'blackhole deduction' provisions. 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 certain new capital deductions for pre- and post-business expenditures deductible under the amended s 40-880. On this basis the pre- and post-business expenditures deductible under s 40-880 will not be generally prevented from being deducted against other assessable income where the pre- and post-business expenditures relate to a business activity that satisfies one of the tests in div 35, or where the Commissioner exercises a discretion.[68]

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[63] Explanatory Memorandum, New Business Tax System (Simplified Tax System) Bill 2000, [1.5]–[1.7].
[64] *A Tax System Redesigned,* above n 1, 129.
[65] Board of Taxation Post-Implementation Review, above n 43, [1.18].
[66] Explanatory Memorandum, Taxation Laws Amendment Bill (No. 1) 2002, [1.7].
[67] Explanatory Memorandum, Tax Laws Amendment (2006 Measures No. 1) Bill 2006, [2.9].
[68] Ibid [2.5].

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 Labor government moved to partially address these inequities. The federal government further restricted the deductions for NCL[69] to prevent around 11,000 high wealth individuals with taxable incomes over $250,000 from claiming tax deductions for NCL 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 for the Bill as introduced summarised 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.
>
> 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.

Thus, the public consultation proved to be effective as it ensured that discretions granted prior to these changes in the *Tax Laws Amendment (2009 Budget Measures No. 2) Act* 2009 were honoured, and ensured that the new div 41 dealing with capital allowances was consistent with the NCL rules.

As proposed, from 1 July 2009, taxpayers with adjusted taxable incomes of over $250,000 have not been able to deduct those expenses against income from the (non-commercial) business activity that results in a loss.[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

[69] Commonwealth Treasury, 'Improving Fairness and Integrity in the Tax System', (Press Release No 067, 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) Bill 2009, [2.9].

[71] Ibid.

[72] ITAA 1997 s 35-10(1)(a), s 35-10(2A), s 35-10(2E)., 35-55(1).

[73] Explanatory Memorandum, Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009, General outline and financial impact.

Whilst this reform substantially reduces the scope for 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 may be able to manipulate their taxable income so as to fall under this threshold.

IV POST IMPLEMENTATION REVIEWS OF THE STS

A *Overview of the Simplified Tax System Legislation*

The STS regime commenced on 1 July 2001. Under the STS regime, a small business taxpayer first needed to work out on an 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 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 required 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]

The STS originally comprised a package of four elements, involving 'simplified' 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 or less.[85] Where the prepayments did not meet this requirement a pro rata deduction for the prepayment was available over the lesser of eligible service period or 10 years.

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[74] ITAA 1997 former s 328-365(1)(a).
[75] ITAA 1997, former s 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] ITAA 1997,s 40-85.
[77] ITAA 1997,s 40-30.
[78] ITAA 1997, former s 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] ITAA 1997, former sub-div 328-C. Note that taxpayers who joined the STS prior to 30 June 2005 can still use the cash accounting system.
[80] ITAA 1936 s 82KZM.
[81] ITAA 1997 sub-div 328-D.
[82] ITAA 1997 sub-div 328-E.
[83] The cash accounting method was abolished prior to the advent of the SBE regime on 30 June 2005.
[84] ITAA 1997, former sub-div 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] ITAA 1936 s 82KZM(1)(aa). This replaced the former 13 month prepayment rule.

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

B *Rationale and Reality*

The tax policy rationale for the STS, as set out in the EM, 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 STS system on economic efficiency[93] and ignored its impact on equity. The STS concessions clearly breached the fiscal adequacy as anticipated by the EM's tax revenue loss estimates.[94] This measure was intended to be a tax expenditure.

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

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[86] ITAA 1997, former sub-div 328-D. 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] ITAA 1997, former s 328-185(1).
[88] ITAA 1997, former s 328-185(2)(a).
[89] ITAA 1997, former s 328-185(2)(b).
[90] ITAA 1997, former s 328-180(1).
[91] ITAA 1997, former s 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 ITAA 1997 div 70.
[92] Explanatory Memorandum, Simplified Tax System Bill 2001, [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 they would minimise 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] H Hodgson, 'Small business simplification – yet again?' (2007) 11 *The Tax Specialist* 140; R Douglas, 'Tax Simplification for Small to Medium Business' (Paper presented at the Taxation Institute of Australia New South Wales State Convention May 2000) 8, 10; M Hine, 'Small Business Tax System (STS)' (Paper presented at the Taxation Institute of Australia, Western Australian State Convention May 2001) 24, 29; I Snook, 'Simplified Tax System: A Favourable Current, a Riptide or Just Plain Dead Calm?' (Paper Presented

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of rules on 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. For example, the STS contained complicated eligibility rules (especially for groups).[97] The inflexibility of the STS was demonstrated 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 they obtained little benefit from the concessions.[98] Also, the STS cash accounting, capital allowance, and trading stock provisions 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 this was inefficient.[101] Further, the concessions only provided a timing benefit from the temporary deferral of income tax.[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 to the legislation. Eventually these matters were addressed by amendment.

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at the Taxation Institute of Australia, South Australian State Convention May 2001) 75, 75; B Bondfield, 'A Year on in the Simplified Tax System: has the reality matched the rhetoric?' (2002) 37 *Taxation in Australia* 253; P Kenny, 'A Simplified Tax System for Small Business: Or, Just Another Tax Preference?' (2002) 6 *The Tax Specialist* 36, 39; J Tretola, (2007) 'The Simplified Tax System — Has It Simplified Tax At All And, If So, Should It Be Extended?' (2007) 17 *Revenue Law Journal* 4; M McKerchar, 'Is the Simplified Tax System Simple?' (2007) 10 *The Tax Specialist* 140, 141–142; M Pizzacalla, 'Australia's SME identity crisis' (2007) 22 *Australian Tax Forum* 19; Samarkovski Freudenberg above n 39; M Burton, '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; G Shaw, 'Changing to the Simplified Tax System' (2005) *Taxpayers Australia* 7 November 2005, 154; M Dirkis and B Bondfield, 'The RBT ANTS Bite: Small Business the First Casualty' (2004) 19 *Australian Tax Forum* 107; G Walker, 'The Simplified Tax System — the Good, the Bad and the Ugly' (2003) 7,20 *CCH Tax Week* 95; L Wolfers and J Miller, 'The Simplified Tax System: Is this Government Speak for "Complex"?' (2001) 35 *Taxation in Australia* 374; F Martin, 'STS Implications' (2001) 36 *Taxation in Australia* 245; ICAA Media Release 'Chartered Accountants Disappointed by Simplified Tax System Bill' 27 October 2000; G Cooper, 'The Government Response to the Ralph Report: An Initial Overview' (1999) 34 *Taxation in Australia* 232.

[96] ITAA 1997, former s 328-365(1)(b).

[97] ITAA 1997, former sub-divs 328-F and 328-G.

[98] Douglas above n 96, 11; Snook above n 96, 77–78; Bondfield above n 96, 332–34; Kenny 'A Simplified Tax System for Small Business' above n 96, 37; Tretola above n 96, 14; Wolfers Miller above n 96, 376.

[99] ITAA 1997, former sub-divs 328-C, 328-D, 328-E.

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

[101] 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 *Ralph Review's* tax revenue modelling that the STS depreciation concessions provided 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 benefited. Other sectors such as retail and professional service providers obtained little benefit. See *A Tax System Redesigned,* above n 1, 721.

[102] ITAA 1997 former sub-divs 328-C, 328-D, 328-E; ITAA 1936, s 82KZM ITAA.

C *Post Implementation Reviews of the STS*

1 *Board of Taxation*

Over its six year life the STS did not prove to be very popular with small business[103] and was subject to significant and sustained levels of criticism by commentators and professional and government bodies (as noted previously). The Board, though, was not tasked with the post-implementation review of the STS. Such an outcome 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] This indicates that the Board operated under a restrictive terms of reference and was not appropriately funded to carry out such reviews.

It was only in December 2007, after the cessation of the STS, 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 clients' 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.
- The various criteria and thresholds for entry increased compliance costs.

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103 ATO Tax Practitioners Forum Issues Log (register n, A27), <www.ato.gov.au/taxprofessionals/content asp?doc+/content/39983.htm&page=165&H28_1>. Only 14 per cent of small business had joined the STS in the year ended 30 June 2002.
104 *A Tax System Redesigned*, above n 1, 275–76.
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.

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

2 *Consequential Amendment 2001: Research and development activities*

As a result of changes in the treatment of expenditure on depreciating assets used for research and development, the deductions for depreciating assets used in carrying on research and development activities were worked out under ITAA 1936 s 73BA from 1 July 2001 (ie separately from the STS).[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 the new section.

3 *Ad hoc Amendment 2002: STS interaction with other provisions in the ITAA 1997*

A number of inconsistencies became clear, reflecting the hurried implementation of the STS. *Taxation Laws Amendment Act (No. 5) 2002* attempted to ensure that the STS capital allowances system operated as intended, and interacted appropriately with the capital allowances system, capital gains tax regime, and the dictionary to the legislation.

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

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

The capital gains tax rules[114] 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 s 328-175(6) were amended to allow a deduction to be claimed unless it was 'reasonably expected' that the depreciating asset would be predominantly leased in the future (rather than 'intended' to be leased). This would provide greater clarity since taxpayers would not always be in a position to know how a depreciating asset was intended to be used, and may have had difficulty in interpreting this provision.[115]

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[111] Ibid 94.
[112] Explanatory Memorandum, Taxation Laws Amendment (Research and Development) Bill 2001 [2.1]–[2.6].
[113] Explanatory Memorandum, Taxation Laws Amendment Bill (No. 5) 2002 [3.106].
[114] ITAA 1997 s 104-235(4)(b).
[115] Explanatory Memorandum, Taxation Laws Amendment Bill (No. 5) 2002 [3.108].

The STS depreciating asset rules were further amended to allow a deduction for a cost addition (improvements) of less than $1,000 for a low cost asset in the year of purchase.[116] 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 are added to the general STS pool.[117] Further, s 328-180(2) also allows 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, s 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.[118]

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).[119]

4 *Ad hoc Amendment 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 sub-div 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[120] optional roll-over relief was provided.[121] 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.

5 *Ad hoc Amendment 2005: STS accounting method; Further STS roll-over relief; the STS entrepreneurs discount*

The mandatory STS cash accounting basis created a number of problems for many small businesses that utilised accruals accounting and who obtained little benefit from the

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[116] ITAA 1997 s 328-180(2).

[117] ITAA 1997 s 328-180(2); Explanatory Memorandum Taxation Laws Amendment Bill (No. 5) 2002 [3.109].

[118] Ibid [3.111].

[119] Ibid [3.112]–[3.113].

[120] Explanatory Memorandum, Taxation Laws Amendment Bill (No. 2) 2004, [7.5] states 'Roll-over relief is not currently available for reconstitutions of partnerships operating under the STS (ie STS partnerships), deterring some taxpayers from joining the STS. This measure will allow optional roll-over relief for STS partnerships subject to certain conditions.'

[121] ITAA 1997, former s 328-240; ss 328-243, 328-245.

concessions.[122] Consequently, the cash accounting system was abandoned from 1 July 2005.[123] 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 taxable income using the most appropriate method applicable to their circumstances.'[124] It took four years, though, to fix this obvious flaw in the STS.

In another anomaly for a 'simplified' system, the STS provided roll-over relief that 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 a STS pool under s 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.[125]

An entrepreneurs' tax offset (25 per cent) was introduced in respect of the income tax payable on business income for STS taxpayers that had an annual turnover of $75,000 or less. Where STS turnover was greater than $50,000 the offset phased out so that the offset ceases once STS turnover reaches $75,000. The EM provided the following rationale:[126]

> 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 was estimated to cost the revenue $400 million in 2006-07 and $390 million in 2007-08.[127] Rather than fixing the flaws in the STS this measure created more inequities and inefficiencies since the offset mainly benefited STS taxpayers with higher turnovers near the $75,000 cut off that had few deductions. Other taxpayers received little or no benefit from this measure. Further, the ATO incurred additional administration costs in managing the new STS concession. Overall, this measure appears

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[122] Douglas, above n 96, 11; Snook, above n 96, 77–78; Bondfield, above n 96, 332–34; Kenny 'A Simplified Tax System for Small Business', above n 96, 37; Tretola, above n 96, 14; Wolfers Miller, above n 96, 376.

[123] *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 *Income Tax Transitional Provisions Act 1997* (ITTPA 1997) s 328-100.

[124] Explanatory Memorandum, Tax Laws Amendment (2004 Measures No. 7) Bill 2005, General outline and financial impact.

[125] Ibid: '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.'

[126] Ibid.

[127] Ibid.

to have breached all of the tax policy criteria. This appears to have been a vote gathering exercise designed for the 2004 election.

6 *The Banks Taskforce: 2007 Small Business Entities regime 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.[128] The *Banks Taskforce's* report *Rethinking Regulation* was provided to the federal government on 31 January 2006.[129] The submissions to the *Banks Taskforce* called for a consistent definition of small business.[130] 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.[131]

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.[132] 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.[133]

The SBE test provided a new measure for determining what constitutes a small business.[134] From 1 July 2007, SBEs have the choice to apply any of the SBE concessions since they are no longer compulsory,[135] unlike most of the former STS concessions.[136] Under the SBE rules there is no need to lodge an election with the ATO to access the concessions.[137] The former $1 million STS average turnover threshold[138] was replaced with a $2 million aggregate turnover threshold[139] and the former STS $3 million depreciating assets test was abolished.[140] 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.

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128 Banks Taskforce, above n 18.
129 Ibid.
130 Ibid.
131 Ibid 169–170, Recommendation 5.43.
132 *Tax Laws Amendment (Small Business) Act 2007.*
133 ITAA 1997 sub-div 328-C.
134 ITAA 1997 s 328-110(1).
135 Ibid.
136 ITAA 1997 former sub-divs 328-C, 328-D; ITAA 1936 s 82KZM.
137 ITAA 1997 sub-divs 328-D, 328-E, ITAA 1936 s 82KZM.
138 ITAA 1997 former s 328-365(1)(b).
139 ITAA 1997 s 328-110(1)(b).
140 ITAA 1997 s 328-110(1).

The SBE test now applies to the following concessions:[141]

- Simpler depreciation rules: ITAA 1997 sub-div 328-D;
- Simplified trading stock rules: ITAA 1997 sub-div 328-E;
- Deducting certain prepaid business expenses immediately: ITAA 1936 ss 82KZM and 82KZMD;
- CGT 15-year asset exemption: ITAA 1997 sub-div 152-B;
- CGT 50% active asset reduction: ITAA 1997 sub-div 152-C;
- CGT retirement exemption: ITAA 1997 sub-div 152-D;
- CGT roll-over: ITAA 1997 sub-div 152-E;
- Accounting for GST on a cash basis: *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act') s 29-40;
- Annual apportionment of input tax credits for acquisitions and importations that are partly creditable: GST Act s 131-5;
- Paying GST by quarterly instalments: GST Act s 162-5;
- FBT car parking exemption: *Fringe Benefits Tax Assessment Act 1986* s 58GA;
- PAYG instalments based on GDP-adjusted notional tax: *Taxation Administration Act 1953* sch 1 s 45-130.

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 that allow non-SBEs to access the concessions. This undermines the simplicity benefit that could have been achieved from having a single definition of small business.[142] For example, the small business capital gains tax concessions utilise an alternative $6 million net assets test.[143] 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'.[144]

The former STS entry and exit rules in sub-divs 328-F and 328-G were repealed as they are unnecessary under the fully optional SBE regime.[145] However, complex transitional rules were introduced to cater for the move from the STS to the SBE regime.[146]

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[141] ITAA 1997 s 328-10(1).
[142] Hodgson, above n 96, 140.
[143] ITAA 1997 s 152-15.
[144] *A Tax System Redesigned* above n 1, 129.
[145] Explanatory Memorandum Tax Laws Amendment (Small Business) Bill 2007 [4.33].
[146] *Tax Laws Amendment (Small Business) Act 2007,*49–56.

V CONCLUSION

Fast tracking of large scale tax reform such as the *Ralph Review* reforms means that policy proposals and objectives may well be inappropriately conceived and the ensuing legislation may have substantial design deficiencies. Thus, there is a need for effective post implementation review processes.

This analysis illustrates the shortcomings of the ad hoc post implementation amendment and review processes for these enacted *Ralph Review reforms*. The two *Ralph Review* reforms examined, the NCL regime 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. The review processes were limited in scope, under resourced and they did not fully address the underlying policy flaws. The Board's review of the NCL regime was too narrow and the STS was not subject to a formal review but to a series of ad hoc amendments.

One of the key lessons to emerge from such fast tracking of large scale tax reform is that enacted tax reforms need to be subject to a timely and thorough post-implementation review process by an adequately funded independent body (perhaps 2-3 years after implementation).[147] This process must assess the tax reforms having regard to the generally accepted tax policy criteria.[148] An effective post implementation review process also requires extensive consultation and should be ongoing. The views of the general community, academic, and professional commentators and of professional and government bodies, must be regarded in assessing how well the policy goals are met.

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[147] *A Tax System Redesigned* above n 1, 275–76. 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.

[148] Economic efficiency, equity, simplicity and fiscal adequacy. Alm, above n 6, 117.