Tax Working Group Information Release

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This paper has been prepared by the Secretariat to the Tax Working Group for consideration by the Tax Working Group.

The advice represents the preliminary views of the Secretariat and does not necessarily represent the views of the whole Group or the Government.

Some papers contain draft suggested text for the Final Report. This text does not constitute the considered views of the Group. Please see the Final Report for the agreed position of the Group.

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;
[2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials;
[3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions;
[4] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Coversheet: Options for rollover and small business treatment

Position Paper for Session 22 of the Tax Working Group
8-9 November 2018

Purpose of discussion

The attached tables are aimed at trying to help Group members work through their views on various rollover options. The tables set out particular issues, solution options (where more than one is available), technical problems with the solutions, and policy pros and cons with the solutions. The Secretariat are currently preparing costings, with the intention of providing indicative numbers at the meeting.

After the tables is a note on small business concessions. These concessions do not all take the form of rollover, but the decision about small business concessions may be influenced by decisions on rollover relief, and vice versa.

As a general point, we reiterate that particularly for the business rollovers, if these are required then there will be a greater need for capital loss ring-fencing to guard against "cherry picking" where taxpayers roll assets over that have increased in value and crystallise losses on assets that have decreased in value.

The first table is about death and gifting, and the second is about business rollovers.

The tables do not include material on rollover for compulsory acquisition, business reorganisations, or transfers to spouses and ex-spouses, which the Group agreed at meeting 20. They also assume that the business rollovers are confined to "business assets", so would not include passive shareholdings, or passive land-owning (e.g. rental property or baches). Equally, it is assumed that nothing that is currently taxable would qualify for rollover relief (e.g. a property developer who builds and sells property would not receive rollover relief under any of the business rollovers).

Recommended actions

A suggested way to work through the tables is to look at the issues in the left hand column, see if you agree that this is an issue that needs to be fixed, and then look at the suggested solutions, picking the best one, informed by the material to the right which covers technical problems and policy pros and cons with the solutions.

At the end of the exercise the idea is that the table will have helped to:

a. Identify where there is agreement and disagreement about whether something is an issue that needs to be resolved.

b. Identify where there is agreement about the issue, but disagreement about the solution.

c. Record everyone's position on the issues and solutions. Some initial views expressed by Geof, Michelle, Robin, Craig and Joanne of their preferred solutions are recorded in brackets beside the relevant solution.

Options for rollover and small business treatment

Position Paper for Session 22
of the Tax Working Group

November 2018

Prepared by the Inland Revenue Department and the Treasury

Treasury:4032451v1

1. Rollover on death and gifting

1. The Group needs to decide whether, if there is rollover on death, the same tax treatment should also apply to gifts made during the person's life. There is a trade-off between consistency of treatment for gifts and death and tax integrity concerns. It has also been suggested that providing rollover on gifts may provide some simplicity benefits by avoiding the need for some other complex integrity rules.

2. The Secretariat has considered the following arguments:

- **Does rollover for gifts remove the need for complex anti-avoidance rules for trusts (whereby a trust is deemed to realise its assets every 20 years or on the death of a settlor, etc)?** In our view, allowing rollover for death would remove the need for a deemed realisation every 20 years, etc. We note that further anti-avoidance rules for trusts may be needed, but it is not obvious to us that requiring rollover for gifts would remove the need for these.

- **Does rollover on gifts prevent people bringing forward losses by transferring depreciated assets to associated persons?** Rollover for gifts would not address this concern, as people could avoid the rollover treatment by transferring at, or above, market value if the asset has genuinely depreciated (as it will not be a gift). Instead, this issue needs to be fixed by some other means (e.g. making rollover mandatory for transfers between associated persons that result in a loss, ring-fencing losses on transfers between associated persons, and/or specific anti-avoidance rules).

  We also note that, if rollover is to be used as an anti-avoidance measure, it cannot be confined to natural persons. If rollover for transfers between associated persons is extended to companies and other non-natural persons, it would create more avoidance opportunities (e.g. people could transfer appreciated assets to a loss company and access those losses).

- **Does rollover for gifts remove the need for the associated persons rules that deem transactions to take place at market value?** If rollover for gifts is used as an anti-avoidance measure as suggested above, transfers at undervalue should also be partially rolled over as they consist of, in a sense, a partial gift. However, to determine if something is a partial gift, you still need to work out what the market value is.

3. While it is common for countries to provide broad rollover on death, rollover on gifting is usually more limited. The following table sets out the treatment in Australia, Canada, the UK and South Africa:

Table: Rollover treatment on death and gifting across four countries

Country	Rollover on death	Rollover on gifts	Require proceeds at market value on non-rollover transactions?
Australia	All assets to anyone	None	Yes
Canada	Transfers to spouse and certain transfers of farm, forestry, fishing property to children	Gifts to spouse	Yes
UK	All assets to anyone	Gifts to spouse and gifts of operating business assets, unlisted shares in trading companies and agricultural land to another individual or trust	Yes
South Africa	Transfers to spouse	Gifts to spouse	Yes

Death and gifting

Issue	Solution(s) (Group members initial preferences shown in brackets)	Technical problems with solution	Policy pros	Policy cons
A. Charging tax on death will lack public acceptance	1. Rollover on death for all assets **(Robin, Joanne)**	None		Reduces fairness and efficiency benefits of taxing more capital gains generally. Increases lock-in over time as cost basis does not get reset on death
B. Charging tax on death will be a problem for large operating businesses when the owner dies	1. Rollover on death for all assets	None		Reduces fairness and efficiency benefits of taxing more capital gains generally. Increases lock-in over time as cost basis does not get reset on death
	2. Liquid/illiquid distinction **(Geof, Craig, Michelle)**	Maintaining the integrity of liquid/illiquid definitions over time	Allows the tax to apply on a greater number of assets	Reduces fairness and efficiency benefits of taxing more capital gains generally, and makes arbitrary distinction based on "liquidity" of assets. Increases lock-in of illiquid assets over time as cost basis does not get reset on death
	3. Defer tax for x years	None – relatively common in other countries	Limits lock-in over time by resetting cost basis	Still some difficulties from having to fund the tax within x years
C. Charging tax on death will lack public acceptance but letting large fortunes grow through generations is worse, so a solution is needed for the very wealthy	1. Rollover on death for assets/capital gain as measured below a threshold	May cause issues for large operating businesses (see potential solutions to the row above)	Achieves some vertical equity goals	Without options for deferral of tax, could cause compliance costs/fire sales of operating businesses that are over the cap. Designing and applying a threshold is likely to be complex
D. Some rollover on death is necessary, but allowing it for gifting is a step too far given the greater flexibility and ways to defer tax if rollover for gifting	1. Limited rollover for gifting (rollover for gifts to spouse and non-income generating personal assets such as baches to natural persons) **(Geof, Craig, Michelle – anti-avoidance rules needed – mandatory rollover for losses etc.)**	None – relatively common in other countries	Better maintains integrity of the tax system, and limits rollover compared to full rollover for both gifting and death	Might increase lock-in by incentivising people to hold assets until death.
E. If rollover is allowed for death but not for gifting, that would incentivise people to hold assets until death	1. Rollover on death and gifting for all assets to any person **(Robin, Joanne)**	Will require extensive anti-avoidance rules to ensure people cannot take advantage of rollover to use another person's lower tax rate, or tax losses, or other favourable tax treatment. e.g Gift appreciated assets to someone on a lower tax rate, and depreciated assets to someone on a higher tax rate. **(See discussion on prior page for more detail)**	Removes lock-in incentive to hold assets until death	Reduces fairness and efficiency benefits of taxing more capital gains generally. Added complexity of anti-avoidance rules

Business asset rollovers

Issue	Solution(s) (Group members initial preferences shown in brackets)	Technical problems with solution	Policy pros	Policy cons
F. Lock-in for business assets is a problem that should be fixed	1. Like-kind/similar asset rollover for businesses (e.g. land for land)	Defining what assets are similar – but this is commonly done overseas so there is precedent	Resolves lock-in problem for replacement assets	Reduces fairness and efficiency benefits of taxing more capital gains generally. Creates lock-in into a particular asset class and difficult to justify not allowing rollover for all business assets
	2. Business asset rollover (no like-kind restriction) **(Robin and Joanne – would not include trading stock, portfolio or passive interests such as rental property. Query how it would apply to sale in shares in a close company, and goodwill)**	Defining what qualifies as a "business asset"	Resolves lock-in problem for business assets	Reduces fairness and efficiency benefits of taxing more capital gains generally. Creates lock-in into "business assets", when it may be more efficient to invest in something else
G. Tax on capital gains should not be an impediment to small business growth	1. Like-kind/similar asset rollover for small businesses **(Michelle, Craig, Geof,– with generous thresholds)**	Defining qualifying small business (consider Australian model) and defining what assets are similar – but this is commonly done overseas so there must be precedent	Resolves lock-in problem for replacement assets for small businesses	Reduces fairness and efficiency benefits of taxing more capital gains generally. Creates lock-in into a particular asset class and difficult to justify not allowing rollover for all business assets
	2. Business asset rollover (no like-kind restriction) for small businesses	Defining qualifying small business (consider Australian model) and defining what qualifies as a "business asset"	Resolves lock-in problem for business assets for small businesses	Reduces fairness and efficiency benefits of taxing more capital gains generally. Creates lock-in into "business assets", when it may be more efficient to invest in something else
H. Charging tax on gains in values of small businesses is unfair because the business sale is used to fund retirement **[Not a rollover issue]**	1. No solution required – in New Zealand retirement savings income of all people is generally taxed. No reason to exempt gains on small businesses. Should look rather at compliance costs. **(Michelle, Craig, Robin and Joanne)**	None	Ensures capital gains are taxed just as other income is taxed.	
	2. Lifetime exemption for gains on the sale of a small operating business below x amount	Defining qualifying small business and what qualifies as a qualifying retirement event. Precedent in Australia provides options.		Reduces fairness and efficiency benefits of taxing more capital gains generally. Would bias saving through a small business compared to shares, managed funds, property.
	3. Exempting all gains on sale of a small operating business if held for a long time and owner is retirement age **(Geof – with some reservations)**	Defining qualifying small business and what qualifies as a qualifying retirement event. Precedent in Australia provides options.		
I. The tax may impose undue compliance costs on smaller businesses relating to valuations of small closely-held assets **[Not a rollover issue]**	1. Provide alternative options for valuing small closely held assets **(Robin, Craig and Joanne)**	Designing reasonable alternatives to market value Defining which assets the alternative valuation options would apply to (would exclude land and listed shares)	May reduce compliance costs of obtaining valuations for small closely-held assets	Some valuation options could be less favourable (overtax) compared to market value

2. Small business treatment

1. The Ministers of Finance and Revenue have invited the Group to consider whether a tax-free threshold for the sale of a business would be appropriate.

2. There are two potential types of small business *de minimis:*

   - to provide rollover relief in those cases where the proceeds from the sale of small business assets are reinvested into other small business asset (e.g. a farmer selling a farm to buy a different farm).

   - an exemption that would apply regardless of whether the proceeds are reinvested (e.g. sell a business to fund retirement).

3. An exemption is a more generous option than rollover as it doesn't require reinvestment in a new business asset (so would have broader scope and greater uptake) and provides a permanent exemption from paying tax on the gains. Rollover defers the tax until a future time when the new asset is sold (and that sale doesn't qualify for rollover).

4. The type of exemption or rollover provided for small businesses may depend on the policy objectives. Possible objectives include:

   - *Ensuring the tax is not a barrier to expansion and reinvestment by small businesses.* This could be addressed by providing rollover when a small business sells an asset and reinvests the proceeds into another small business asset.

   - *Preserving retirement savings* – many small business owners fund their retirement by selling their business. A lifetime exemption amount (such as not taxing the first $500,000 of gains) for gains made when a person sells their business to retire would preserve the value of these savings. However, it would reduce fairness and efficiency by providing a concession for saving through a small business that is not available for other types of savings such as managed funds, shares or property. There could also be complexity and compliance costs from keeping track of different sources of small business gains over the business owner's lifetime.

   - *Reducing compliance costs* – a small annual exemption amount could reduce compliance costs by ensuring small businesses that only make small annual gains do not need to calculate tax or file returns while ensuring tax is still collected on the larger gains which raise most of the revenue from the tax.

5. Australia has a mix of rollover, exemptions and discounts for small businesses – these concessions are summarised in Appendix one.

6. The value of small business lifetime exemptions varies between countries. Australia's lifetime exemption is set at AUD $500,000 of capital gains. Canada has lifetime exemptions of CAD $840,000 for the sale of shares in closely-held companies and CAD $1m farm and fishing property – these are explained in Appendix two. South Africa provides rollover for a small lifetime exemption of R1.8m (NZD $190k) of capital gains from active assets of small businesses that have less than R10m (NZD $1.05m) of total assets – described further in Appendix three.

7. Regardless of what type of small business concession was used, definitions would need to be developed for defining a small business and identifying the business assets that should qualify.

Defining a small business

8. Australia defines a small business as one with annual turnover of less than AUD $2m and net CGT assets of less than AUD $6m. 97% of Australian businesses have annual turnover of less than $2m, but data is not available on the assets owned by businesses in Australia. AU$6m appears to be a high amount of net assets (especially as CGT assets exclude depreciable property and trading stock).

9. Australia's thresholds reflect the fact that small businesses with low turnover and low net assets may have less funds available to pay a CGT if they sell an asset to realise a large gain. However, there appear to be some disadvantages to Australia's approach. Annual turnover can be reduced by winding down a business prior to selling its assets and net assets can be reduced by taking on more liabilities such as debt. A net asset measure also means businesses with more debt may be treated more favourably than similar sized businesses with less debt. Finally, having two thresholds adds complexity and increases horizontal equity concerns whereby two similar sized businesses can have different tax treatments.

10. The Secretariat therefore considers a total assets threshold may be a better approach. A small business could be defined as a business with total assets below a certain value.

11. As shown by the tables below and the charts in Appendix four, most businesses in New Zealand are small, but most business assets are owned by large businesses.

Distribution of businesses, assets and untaxed realised gains by asset bands, 2017

	Asset band						
	0 or blank	**$1 to $1m**	**$1m to $2m**	**$2m to $5m**	**$5m to $10m**	**over $10m**	**TOTAL**
Number of business entities (all IR10 entities)	138,146	462,573	66,786	51,232	17,892	10,975	747,604
Number with untaxed realised gains	2,644	13,345	4,854	4,822	1,942	1,469	29,076
Total assets ($m)	$0	$109,509	$94,263	$158,812	$123,133	$310,540	$796,257
Untaxed realised gains ($m)	$971	$2,342	$1,202	$1,929	$1,284	$2,522	$10,250
Average assets per entity ($m)	$0.0	$0.2	$1.4	$3.1	$6.9	$28.3	$39.9

Source: Inland Revenue, IR10 returns, 2017 Financial year

Distribution of New Zealand businesses[1] and assets by sales band, 2017

	Sales band				
	Zero	**>$0-<$1m**	**$1m-<$5m**	**$5m-<$10m**	**≥$10m**
Number of businesses	19,527	392,541	44,592	5,583	5,808
Value of total assets ($m)	$274,950	$382,815	$186,613	$43,413	$1,080,925
Average assets per business ($m per business)	$14.1	$1.0	$4.2	$7.8	186.1
% of all businesses	4.2%	83.9%	9.5%	1.2%	1.2%
% of all assets	14.0%	19.4%	9.5%	2.2%	54.9%

Source: Statistics New Zealand, Annual Enterprise Survey 2017 Financial Year

12. For instance, 88% of all businesses have annual sales of less than $1m and these businesses own 33% of business assets. 99% of businesses have annual sales of less than $10m and these businesses own 45% of all business assets.

13. This suggests a small business measure could be designed to provide relief for more than 90% of all businesses, whilst ensuring the general rules for taxing capital gains still applied to 55% to 66% of all business assets.

14. One issue would be how to measure the threshold when a person owns multiple businesses. The rules would need to ensure that a business could not simply split their assets across several different companies in order to access the *de minimis.* For example if the threshold was $5m of assets and Company A has $4m assets and Company B has $2m of assets and they are both controlled by the same person, neither company should qualify for the *de minimis.*

15. This sort of rule would disqualify larger organisations (including, for example, conglomerates, or iwi) that own several small businesses from accessing the small business exemption.

16. Australia's rules address this issue by requiring businesses to aggregate the turnover and assets of any commonly controlled entities (this is similar to consolidation). A 2005 post-implementation review by the Australian Board of Taxation noted that the need to identify connected entities when applying the thresholds gave rise to relatively high compliance costs.

17. A view on whether such rules are appropriate depends on the reason for the small business concession. If it is related to the circumstances and sophistication of the owner then it is

1. Note that these statistics treat each legal entity as a separate business so a consolidated group comprising 10 small companies would count as 10 small businesses, rather than one large business. They will therefore overstate small businesses and understate large businesses.

likely that there should be rules that disallow the concession where an organisation or owner has several small businesses.

Qualifying business assets

18. A qualifying business asset could be defined as real property (land and buildings) and intangible property (such as goodwill and IP) that is used to conduct an active business (active assets). This is similar to Australia's definition (see Appendix one).

19. This definition would exclude trading stock, depreciable property and land / buildings that are rented out to a third party (rather than used by the business). Providing rollover for gains on trading stock and depreciable property (when there is depreciation recovery income) would be inconsistent with the fact that this property is currently subject to tax on disposal. Providing rollover for rental property could mean the rollover applied to passive assets rather than active business assets.

20. Shares in other businesses would not generally qualify as this could be used to effectively expand the definition of 'qualifying business assets'. For example, the value of the shares held by a small business may be greater than the value of the underlying active assets. Australia allows shares in another closely-held company to qualify as active assets if the other company has 80% active assets. However, the Australian Board of Taxation noted in a post-implementation review in 2005 that this 80% test is very difficult to apply over time because of high compliance costs.

Rollover treatment

21. The gains on these qualifying small business assets could be rolled over to the extent that they were reinvested in replacement qualifying small business assets. This would allow a small business owner to still receive rollover treatment if they decide to shift into a different type of asset or industry.

22. The amount that qualifies for rollover would be between zero and the threshold depending on how much of the small businesses' total assets were qualifying assets and how much of the sale proceeds were reinvested in other qualifying assets. The deadline for reinvestment could be within one year after the year that the assets were sold. Australia allows two years from the last CGT event.

Secretariat recommendation

23. The Secretariat recommends against any small business concessions. This is because the small business concession is unconnected with the income or assets of the owner. Because of this, it will, in some cases, be vertically or horizontally inequitable. If the Group thinks there should be a small business concession, or if the Group thinks one should be presented, the active business asset rollover seems best suited if the goal is to stop the tax from affecting small business growth.

Appendix one: Australia's capital gains tax concessions for small businesses

Australia has four capital gains tax concessions for small businesses.[2]

Qualifying small businesses

To qualify for the small business concessions the business must have less than AU$2m of annual turnover and less than AU$6m of net CGT assets.

The turnover and assets of commonly-controlled businesses (40% or more common ownership) and affiliates (another business that the person does not control but is expected act in accordance with their directions or wishes) is added together for the purpose of applying these thresholds.

Qualifying assets

The concessions only apply to small business assets that are "active" assets. Active assets are CGT assets that are owned or used in the course of carrying on a business and intangible assets (for example, goodwill) that are inherently connected with the business. They also must have been an active asset for at least half the time they have been owned.

Depreciable property and trading stock are excluded (as they are not CGT assets). Shares in another closely-held company can qualify as active assets if the other company has 80% active assets.

Rollover for small business reinvestment in active assets

Australia provides rollover for small businesses that reinvest in active assets within two years. This means if a small business sells an active asset, they can defer all or part of a capital gain for two years, or longer if they acquire a replacement asset or incur expenditure on making capital improvements to an existing asset within two years of the CGT event. This type of rollover is not available for larger businesses.

Retirement exemptions

Australia has two types of exemptions for small business owners who sell their business to retire or fund their retirement. These are:

- **15-year exemption** – If the small business has continuously owned an active asset for at least 15 years and the business owner is aged 55 or over and is retiring or is permanently incapacitated, they don't have an assessable capital gain when they sell the asset.

- **$500k exemption** – Capital gains from the sale of small business active assets are exempt up to a lifetime limit of $500,000. However, if the small business owner is

[2] www.ato.gov.au/General/Capital-gains-tax/Small-business-CGT-concessions/

under 55, the exempt amount must be paid into a complying super fund or a retirement savings account.

These concessions may make sense in the context of Australia's very concessionary retirement savings regime (as it ensures small businesses owners are not disadvantaged compared to other people who save for their retirement through tax-preferred super funds). They may make less sense in New Zealand given we do not have tax concessions for retirement savings.

50% discount

Australia also allows small business owners to reduce their capital gains on an active asset by 50%. This is in addition to the 50% discount that is generally available for people (but not companies) who have owned an asset for 12 months or more. The combination of these two discounts means a small business (that is not a company) may only pay tax on 25% of a gain on an active asset they have held for at least 12 months.

Cost and uptake of Australia's small business concessions

Australia publishes data about the small business CGT concessions.[3]

The value of the gains that are relieved by all four small business concessions compared against net capital gains is shown below.

Small business concessions as a % of net capital gains

Income Year	2012-13	2013-14	2014-15	2015-16
Small business concessions as a % of net capital gains from the CGT	13.33%	12.34%	8.40%	9.69%

The following tables provide more detailed information on the four types of small business concession and whether they were claimed by individuals, companies or funds.

These tables suggest that small business rollover is less used (and provides less overall relief) than the other small business concessions. However, it should be noted that each of the concessions are optional and small businesses would generally prefer to use an exemption instead of rollover (as rollover requires reinvestment and only provides a deferral, rather than a permanent exemption). This means the uptake for rollover could be expected to be much higher if Australia did not provide the other three small business concessions.

[3] https://data.gov.au/dataset/taxation-statistics-2015-16

Capital gains relieved under small business concessions (AU $m)

	2015-16 Income Year				
Small business concession:	Individuals	Companies	Funds	TOTAL	TOTAL as a % of all net capital gains from the CGT
Active asset 50% discount	1,145	344	2	1,491	3.32%
$500k retirement exemption	922	271	0	1,193	2.65%
15 year retirement exemption	913	244	4	1,161	2.58%
Active asset rollover	379	133	0	513	1.14%
Total small business concessions	**3,360**	**992**	**6**	**4,358**	**9.69%**
	Annual Average (2012-13 to 2015-16)				
Small business concession:	Individuals	Companies	Funds	TOTAL	TOTAL as a % of all net capital gains from the CGT
Active asset 50% discount	935	300	2	1,237	3.61%
$500k retirement exemption	749	266	0	1,016	2.96%
15 year retirement exemption	591	215	3	809	2.36%
Active asset rollover	355	110	1	465	1.36%
Total small business concessions	**2,631**	**891**	**5**	**3,527**	**10.29%**

Number of businesses using Australia's small business concessions

	2015-16 Income Year			
Small business concession:	Individuals	Companies	Funds	TOTAL
Active asset 50% discount	17,504	2,012	38	19,554
$500k retirement exemption	10,101	999	0	11,100
15 year retirement exemption	1,898	321	3	2,222
Active asset rollover	3,517	424	5	3,946
Total small business concessions	**33,020**	**3,756**	**46**	**36,822**
	Annual Average (2012-13 to 2015-16)			
Small business concession:	Individuals	Companies	Funds	TOTAL
Active asset 50% discount	16,171	1,954	25	18,149
$500k retirement exemption	8,793	958	0	9,751
15 year retirement exemption	1,381	272	4	1,657
Active asset rollover	2,967	418	6	3,391
Total small business concessions	**29,311**	**3,601**	**35**	**32,948**

Compliance costs of Australia's small business concessions

The Australian Board of Taxation conducted a comprehensive post-implementation review into Australia's small business CGT concessions in 2005.[4] This review noted a number of points about the compliance costs of the small business concessions which are quoted below.

General compliance costs

- *"The application of the rules to straightforward situations is clear and easily applied and is viewed by tax advisers and taxpayers alike as providing a range of significant and relatively easily accessed benefits for eligible small business entities."*
- *"The evidence indicates that the compliance costs of the small business CGT concessions are not significant for the taxpayers involved. The review suggests the concessions may be a compliance cost issue for tax practitioners who may not be able to pass on most of those costs to their clients. Aggregate annual recurrent compliance costs were estimated to be up to about $110 million in 2002-03. This estimate is likely to be at the upper end of the range of possible estimates because the estimates are heavily dependent on the value placed on practitioner time and the practitioners surveyed were not fully representative of the general population of practitioners. While these costs are significant in absolute terms, their impact needs to be seen relative to the increased benefit of the concessions to taxpayers."*
- *"The ATO has been able to cope with the small business CGT concessions without undue administrative costs. ATO officers surveyed felt that they have become increasingly more confident in working with the legislation. On a recurrent basis, an internal ATO estimate puts the annual administrative costs of the concessions at about $2.3 million in 2003–04. Although this estimate may have omitted a few minor categories of administrative costs, it may be safely concluded that the administrative costs are not an issue in the operation of the concessions."*

Definition of a small business

- *"The threshold tests, particularly the $5 million net asset value test and its need to identify connected entities, and the controlling individual test, gave rise to relatively high compliance costs."*
- *"Various tests (particularly the three threshold tests) could be quite complex to work out in practice."*

Qualifying small business assets

- *"Many elements of the active asset rules are clear, simple, comprehensible and workable. The 80 per cent look through rule[5] for interests in [other] companies and trusts, however, is very difficult to apply over time, because of high compliance costs."*

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[4] *http://taxboard.gov.au/files/2015/07/small_business_CGT_final_report.pdf*

[5] This refers to a rule whereby shares owned by a business can qualify as active assets if they are shares in another closely-held business which has at least 80% active assets.

Appendix two: Canada's small business lifetime exemptions

Canada provides a tax exemption for capital gains realised by an individual on the disposition of shares in a qualified small business corporation up to a lifetime limit of CAD$848,252 in 2018, indexed to inflation.

A corporation will not qualify if it is controlled directly or indirectly by a public corporation or non-residents, or a combination of the two.

In the 24 months immediately preceding disposition of the shares:

- The shares must have been owned by the individual or a person or partnership related to the individual.
- more than 50% of the assets of the corporation must have been used principally in an active business carried on primarily in Canada by the corporation or a corporation related to it.

At the time of disposition of the shares, at least 90% of the assets must have been used in the active business. Examples of assets that may not qualify as being used in an active business are stocks, bonds, and rental property.

A CAD$1 million lifetime exemption (with similar qualifying criteria) applies to farm and fishing property.

In 2017 the Canadian Government raised concerns that both of these concessions were being abused to reduce personal taxes by noting:

> *"an increasing number of Canadians—often high-income individuals—are using private corporations in ways that allow them to reduce their personal taxes. In some cases, someone earning $300,000 with a spouse and two adult children can use a private corporation to get tax savings that amount to roughly what the average Canadian earns in a year. Only an estimated 50,000 family-owned private businesses are sprinkling income."*

In July 2017 the Canadian Government proposed three measures to prevent this type of income splitting[6]:

- Preventing people aged under 18 (e.g. children) from accessing the exemption
- Applying a reasonableness test which compares the person's contributions to the business against any previous wages or dividends etc. they have received. The higher this difference the more reasonable it is they should share in the capital gains.
- Excluding any gains that accrued while a trust owned the business.

[6] http://www.mondaq.com/canada/x/627126/Capital+Gains+Tax/Proposed+CRA+Changes+To+The+Lifetime+Capital+Gains+Exemption+Canadian+Tax+Lawyer+Analysis

However, in October 2017 the Canadian government decided not to proceed with these proposals but to consider introducing targeted anti-avoidance rules instead.[7]

Appendix three: South Africa's small business lifetime exemptions[8]

South Africa provides rollover for a small lifetime exemption of R1.8m ($190k NZD) of capital gains from active assets of small businesses that have less than R10m ($1.05m NZD) of total assets.

This exemption applies upon death or retirement (aged over 55 or unwell) of the small business owner / operator.

The assets must have been held for at least 5 years before disposal.

An active business asset is defined as:

- an asset which constitutes immovable property, to the extent that it is used for business purposes; or
- an asset (other than immovable property) used or held wholly and exclusively for business purposes,

but excludes—

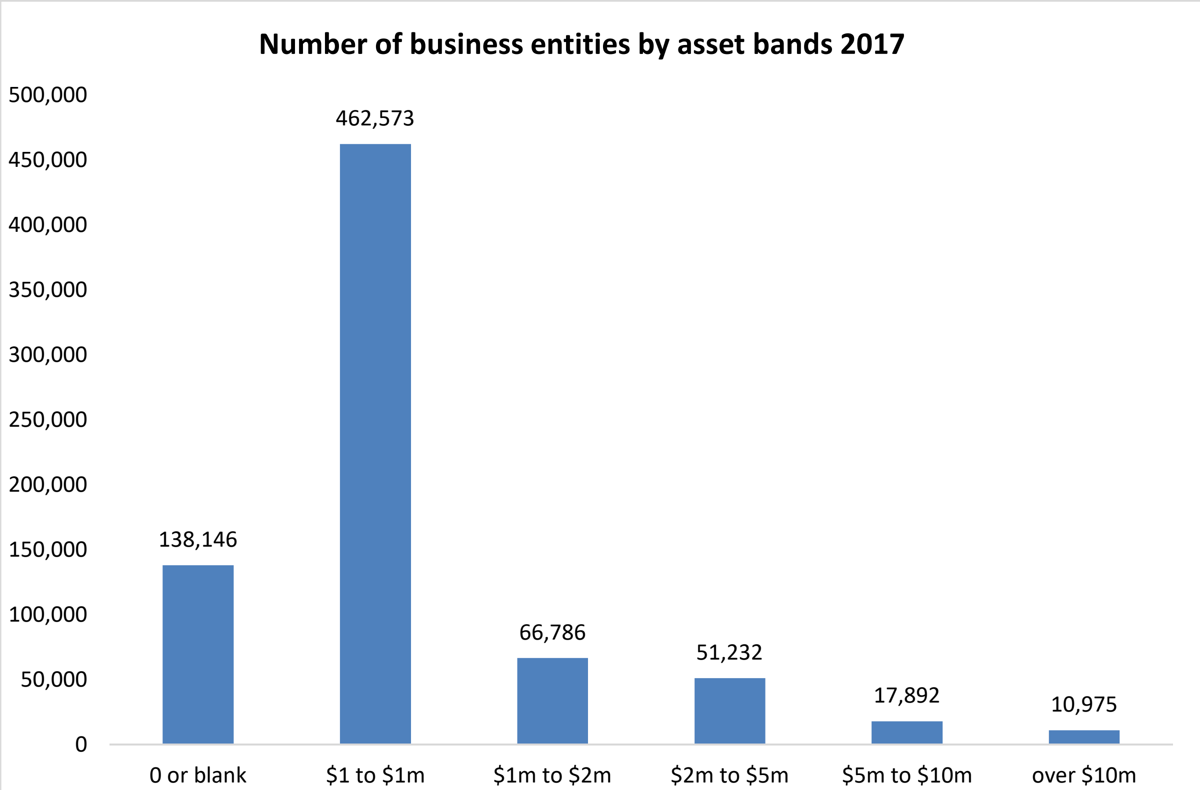
- a financial instrument; and
- an asset held in the course of carrying on a business mainly to derive any income in the form of an annuity, rental income, a foreign exchange gain or royalty or any income of a similar nature.

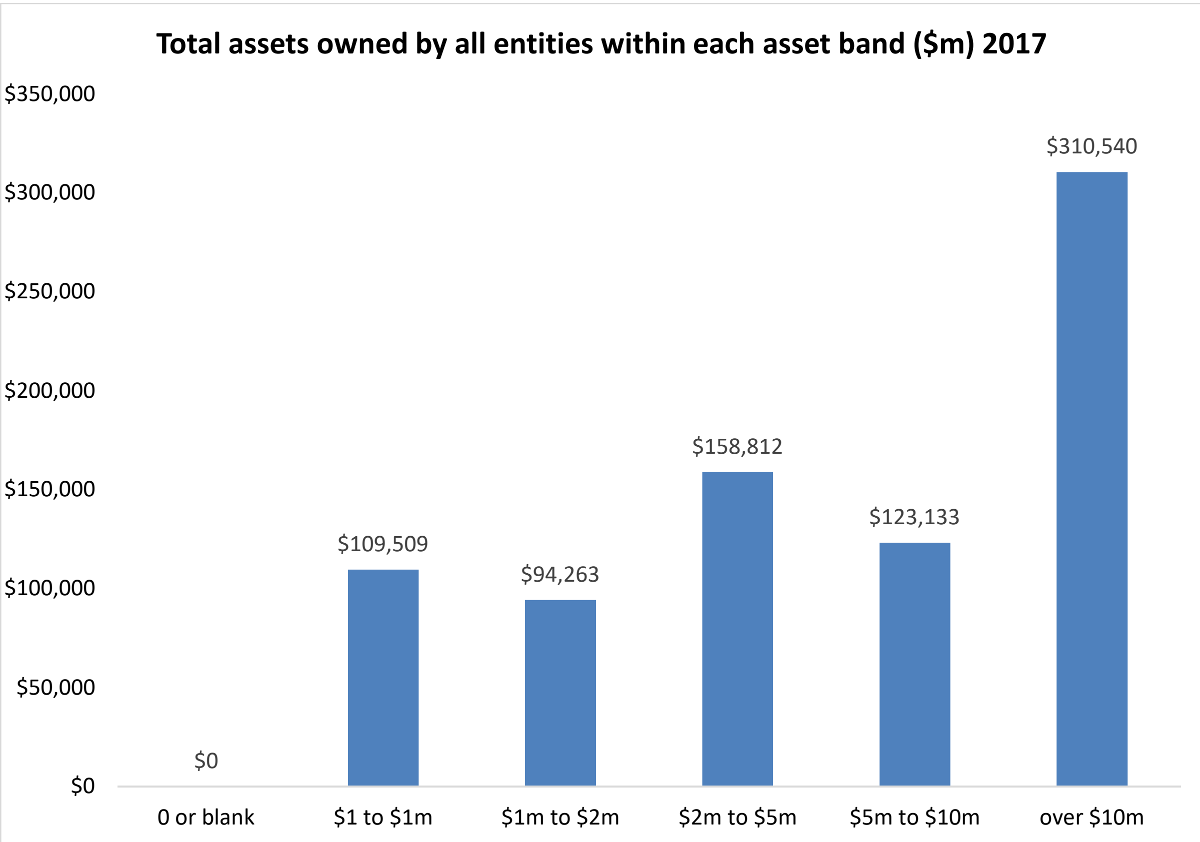
7 https://www.canada.ca/en/department-finance/news/2017/10/targeted_tax_fairnessmeasureswillprotectsmallbusinessownersinclu.html

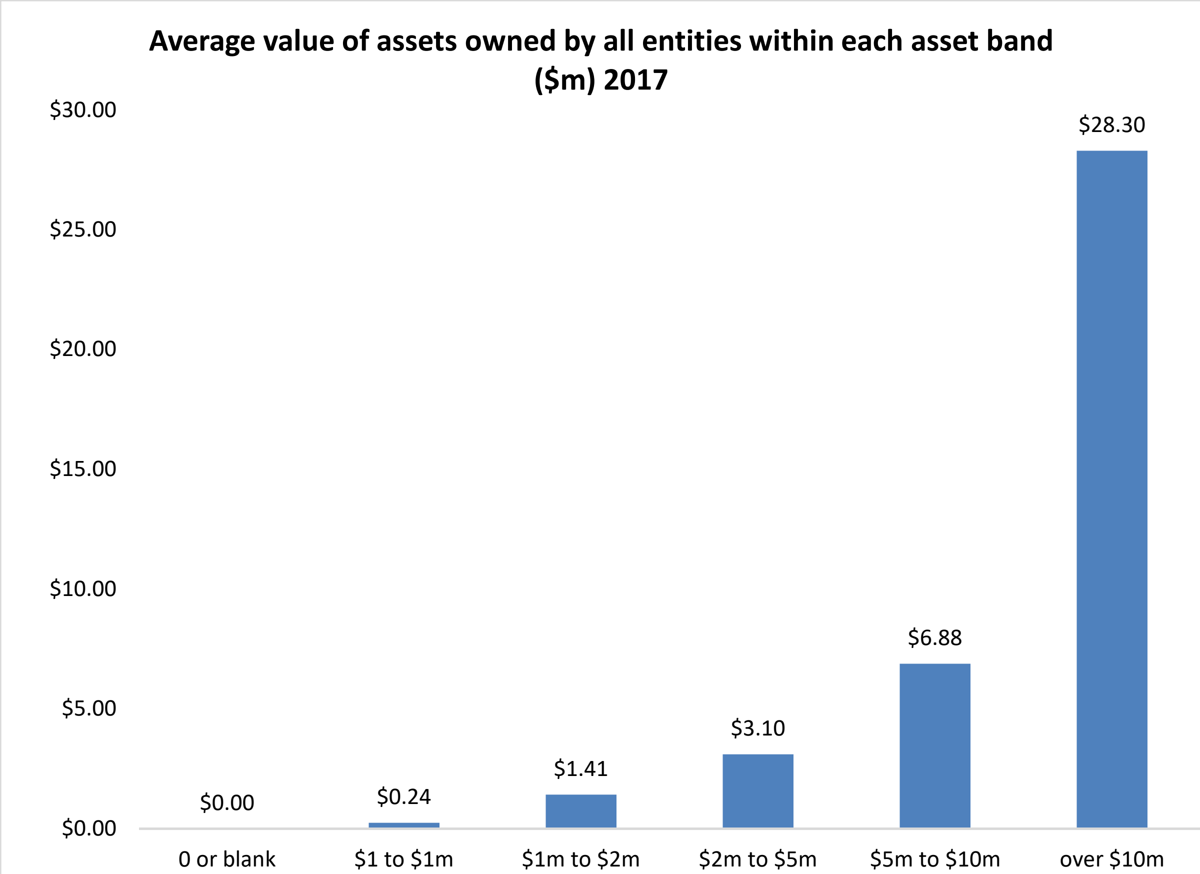
8 http://www.sars.gov.za/TaxTypes/CGT/Exclusions/Pages/Disposal-of-small-business-assets.aspx

Appendix four: Small business data

Small business data from IR10 returns (2017 income year)



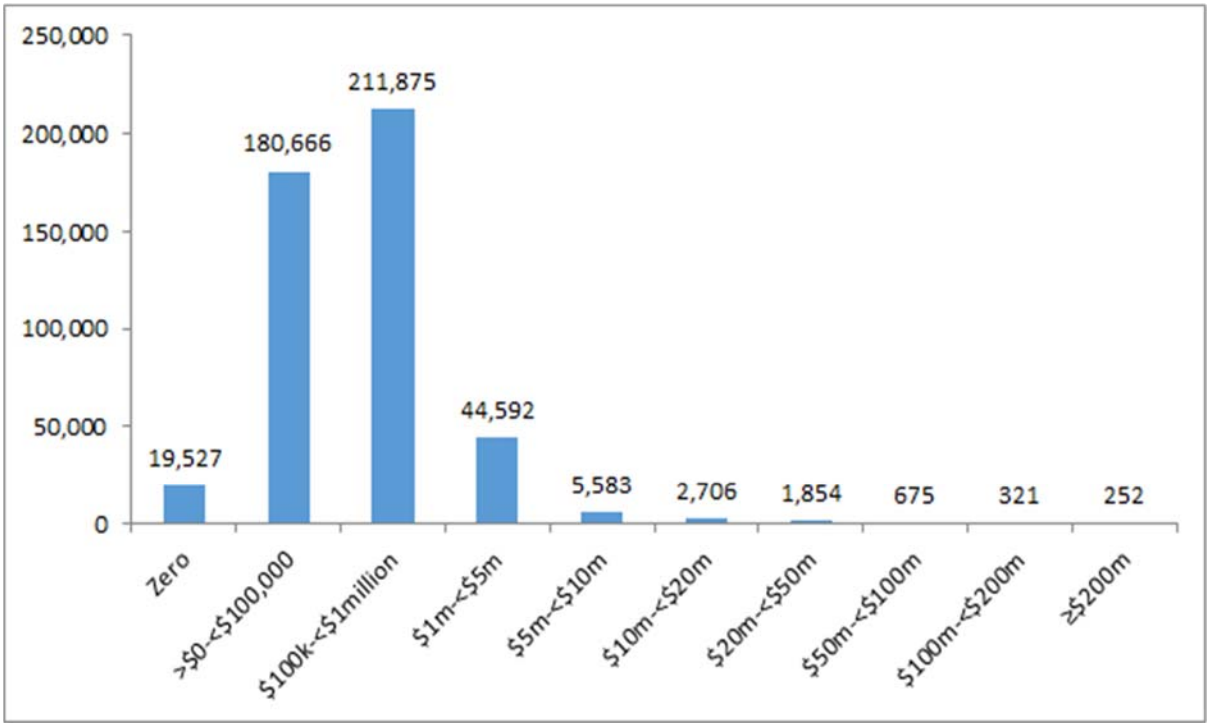



Average value of assets owned by all entities within each asset band ($m) 2017
$30.00
$25.00
$20.00
$15.00
$10.00
$5.00
$0.00
$0.00
$0.24
$1.41
$3.10
$6.88
$28.30
0 or blank
$1 to $1m
$1m to $2m
$2m to $5m
$5m to $10m
over $10m

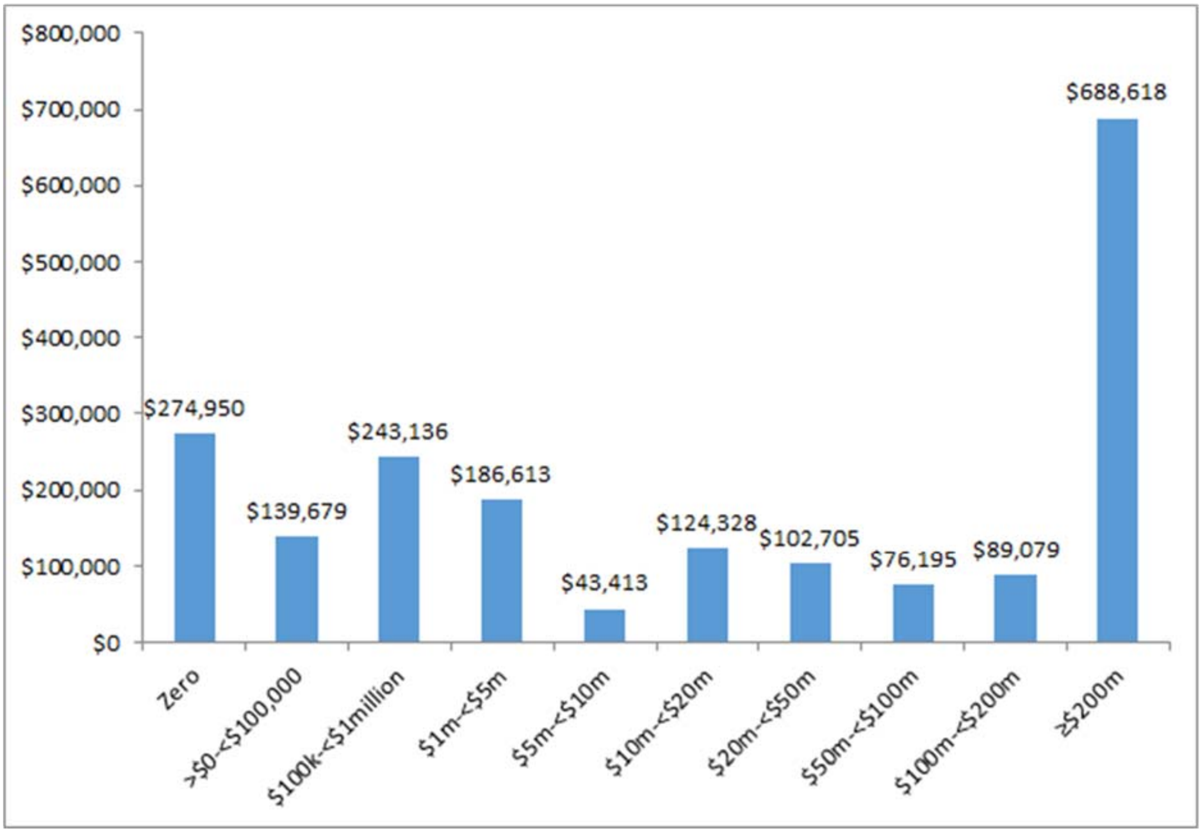

Total untaxed realised gains by asset bands ($m) 2017
$3,000
$2,500
$2,000
$1,500
$1,000
$500
$0
$971
$2,342
$1,202
$1,929
$1,284
$2,522
0 or blank
$1 to $1m
$1m to $2m
$2m to $5m
$5m to $10m
over $10m

Small business data from Statistics New Zealand, *Annual Enterprise Survey* 2017 Financial Year

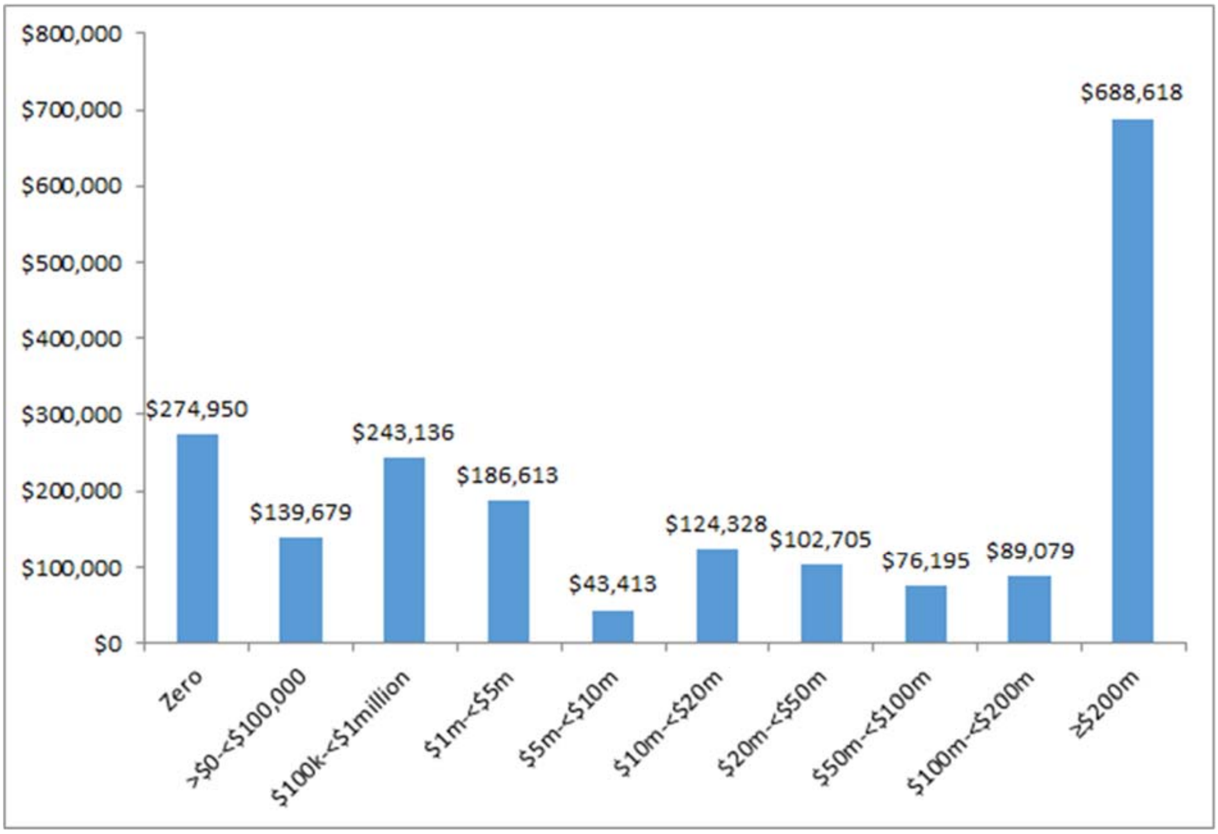
Number of businesses in each sales band, 2017



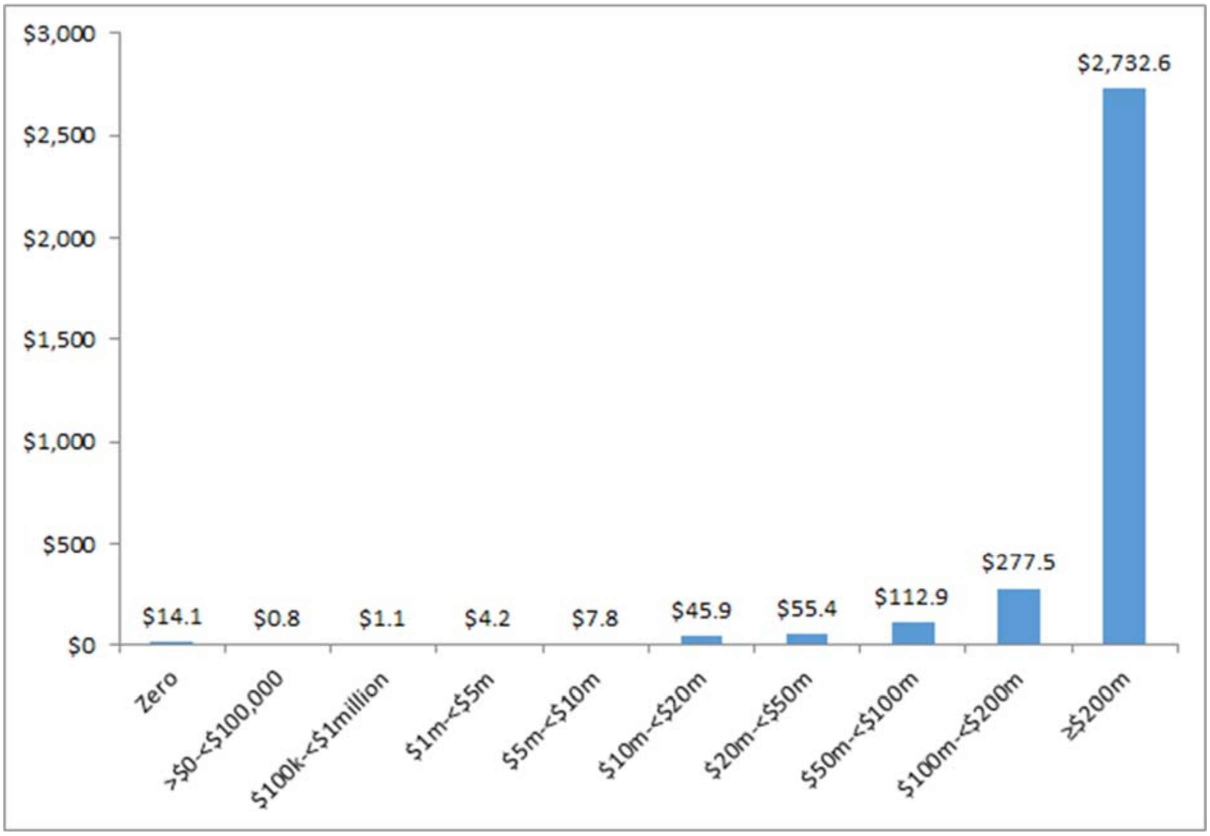
Total assets by sales band ($m), 2017



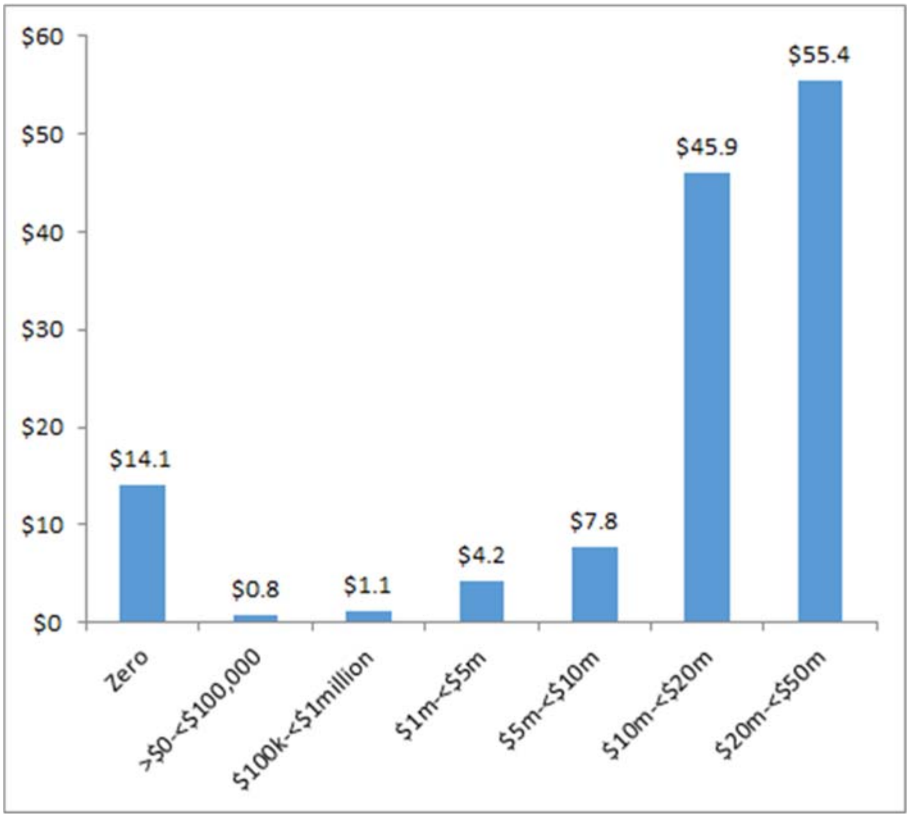
Total assets by sales band ($m), 2017



Average value of assets owned by businesses in each sales band ($m per business)



Average value of assets owned by businesses in each sales band ($m per business)



Distribution of agriculture, forestry and fishing businesses

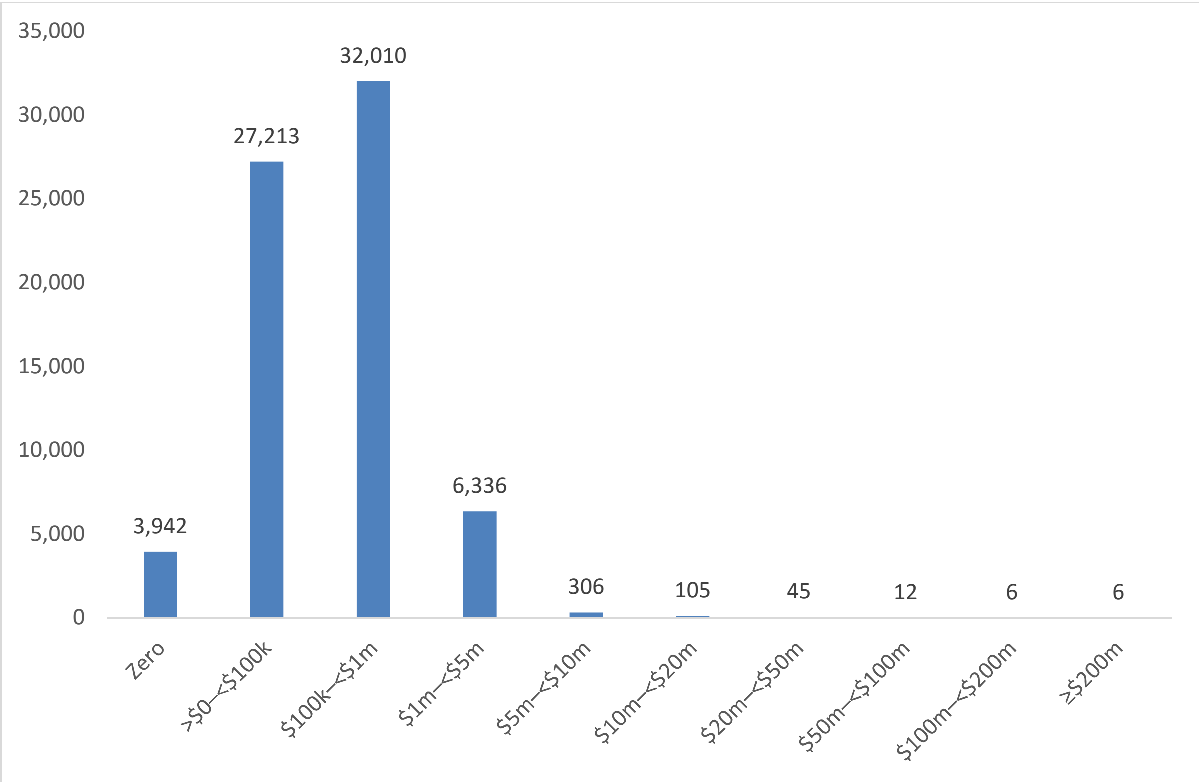
Industry breakdowns are not yet available for the 2017 financial year, but in the 2016 financial year the distribution of agriculture, forestry and fishing businesses is shown in the charts below. (All the following charts use data from Statistics New Zealand, *Annual Enterprise Survey 2016 Financial Year*.)

These figures indicate that 90% of primary sector businesses are small. Less than 7,000 (10%) of primary sector businesses had more than $1m of sales, and less than 500 (1%) had more than $5m of sales.

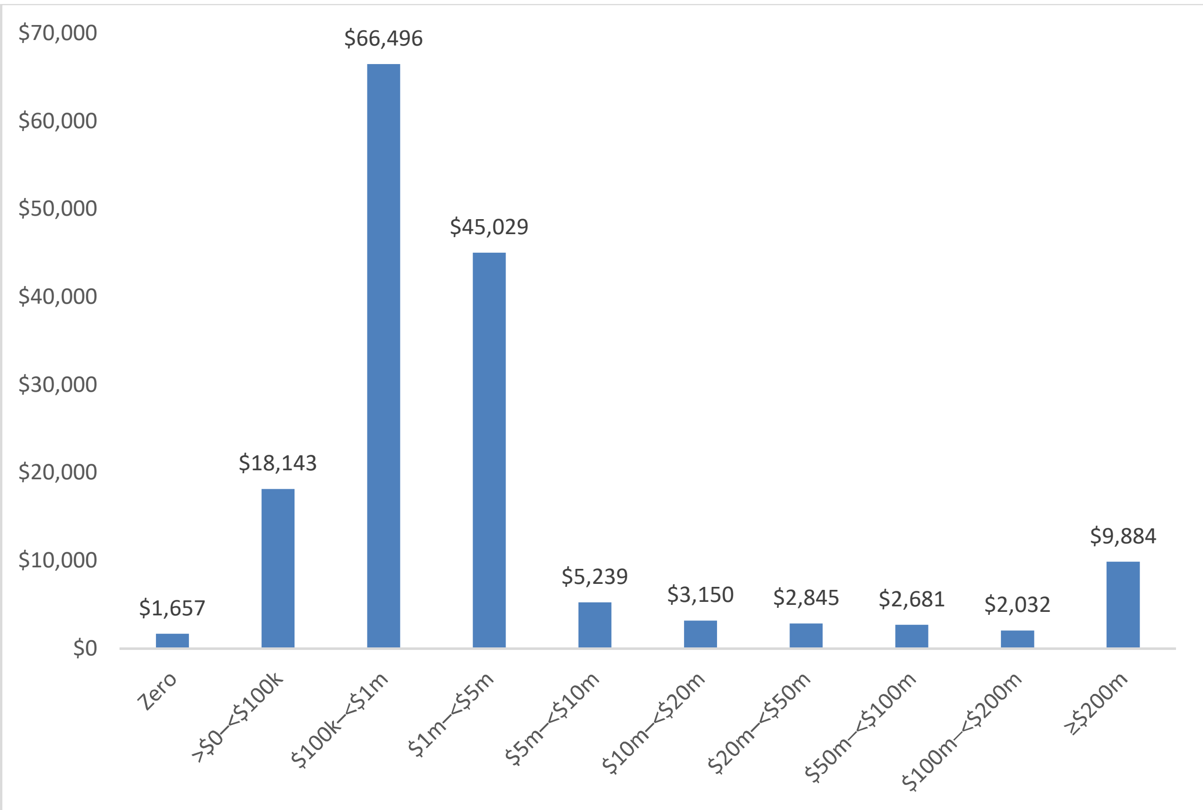
Firms with less than $1m of sales (including nil sales) owned 55% of all agriculture, forestry and fishing assets, while firms with less than $5m of sales owned 71% of assets.

Firms with nil sales made up 5% of firms but owned only 1% of all assets.

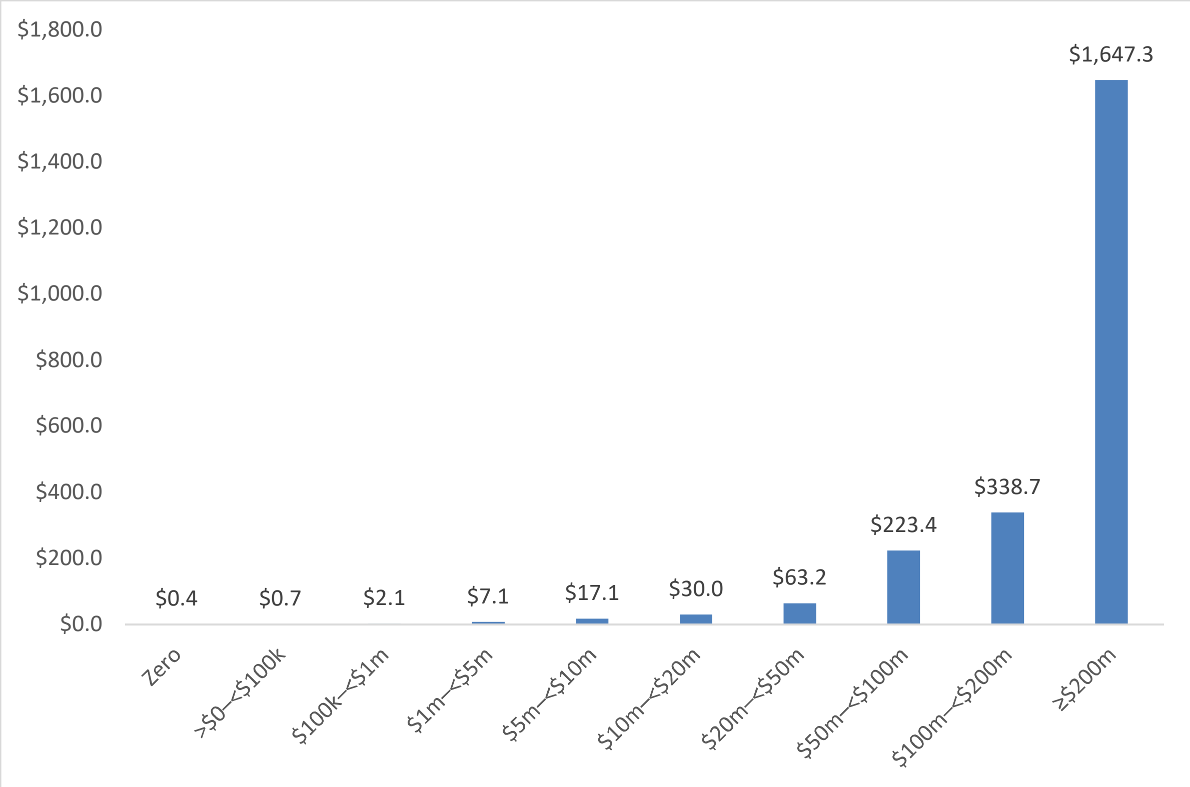
Number of agriculture, forestry and fishing businesses by sales band, 2016



Total value of agriculture, forestry and fishing assets by sales band ($m), 2016



Average value of assets of agriculture, forestry and fishing businesses by sales band ($m per business), 2016



Distribution of firms and assets using employee bands

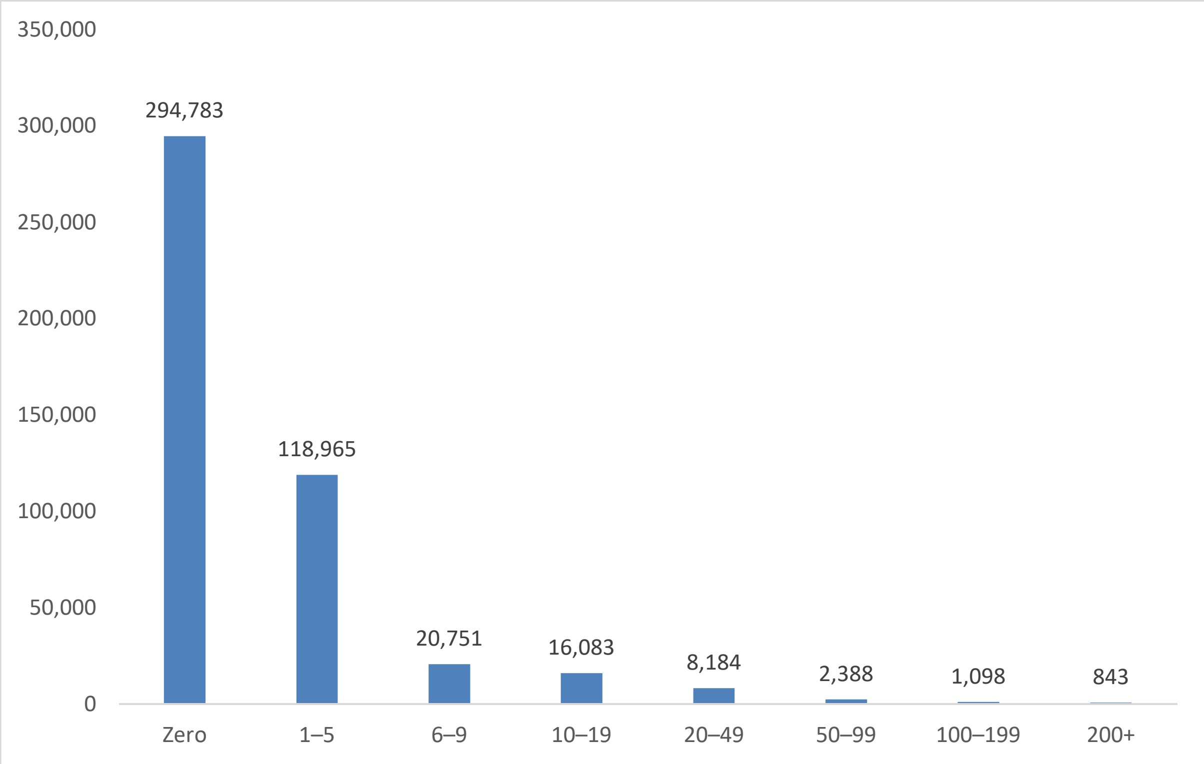
Small businesses are often defined in New Zealand as businesses with fewer than 20 employees.

Firms with fewer than 20 employees make up 97% of all businesses and own 46.5% of all assets.

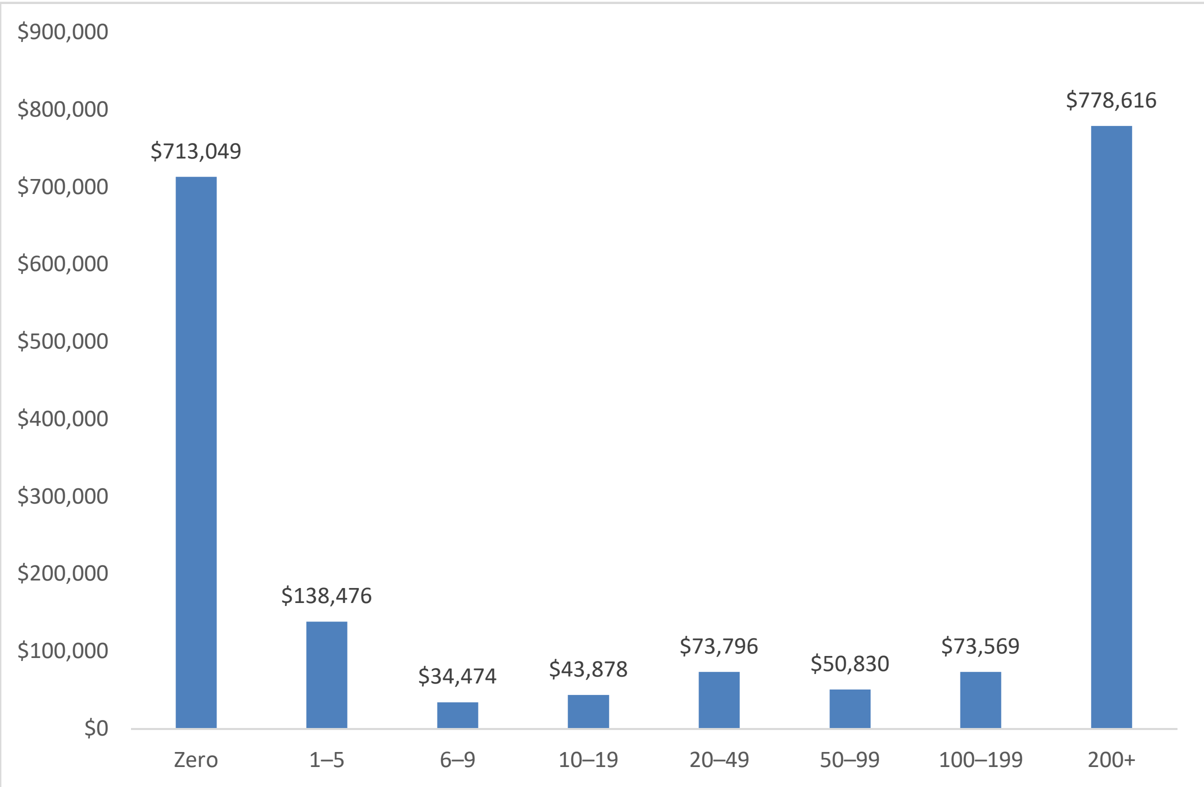
Most small businesses have no employees. In fact, businesses with no employees comprised 64% of all businesses and 37% of all assets.

The following charts use 2016 financial year data to show the distribution of businesses and asset values for firms of different sizes where firm size is measured by their number of rolling mean employees. (All the following charts use data from Statistics New Zealand, Annual Enterprise Survey 2016 Financial Year.)

Number of businesses by employee band, 2016



Total assets by employee band ($m)



Average value of assets owned by businesses in each employee band ($m per business), 2016