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**10 March 2009**

Dear Sir/Madam,

## Small business and general business tax break

We welcome the exposure draft of the *Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009* and appreciate the opportunity to make a submission on the draft legislation.

We have confined our comments to the aspects of the exposure draft legislation which could result in outcomes that are inconsistent with the stated policy objectives of the legislation, refinements that could enhance these objectives, or aspects that could produce anomalous outcomes to certain taxpayers<sup>1</sup>.

We therefore outline our comments and suggestions below.

### 1. Trust distributions and the application of CGT event E4

We believe that an unintended consequence of the *Tax Break* is the potential application of CGT event E4 to certain trust distributions. That is, CGT event E4 may be triggered if an asset that is subject to the *Tax Break*, is held through a trust (or chain of trusts), and there is a resulting trust distribution with an amount referable to the 10% or 30% bonus deduction.

Relevantly, section 104-70 (1) of the Income Tax Assessment Act 1997 (**ITAA 1997**) states the following:

**CGT Event E4** happens if:

- (a) the trustee of a trust makes a payment to you in respect of your unit or your interest in the trust (except for \*CGT event A1, C2, E1, E2, E6 or E7 happening in relation to it); and
- (b) some or all of the payment (the non-assessable part) is not included in your assessable income.

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<sup>1</sup> We specifically refer to the policy objectives stated at paragraph 1.3 of the *Explanatory Memorandum to the Exposure Draft of the Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009*.

That is, a payment by a trustee to a beneficiary of a trust, that is not assessable income of the beneficiary, may result in CGT event E4 being triggered. We note that the consequences of CGT event happening are broadly as follows:

- the beneficiary must reduce the cost base of their unit or interest in the trust; or
- if the amount of the payment exceeds the cost base of the interest, the beneficiary will make a capital gain.

Therefore, if a trustee distributes an amount to a beneficiary, to the extent that such an amount is referable to the additional 10% or 30% bonus deduction (i.e. the "non assessable part", to adopt the language of section 104-70(1)), it is conceivable that the application of CGT event E4 would be triggered.

Given the obvious inequity that such an application could have on beneficiaries (and the divergence from the stated policy objectives of the *Tax Break*), we consider that the application of CGT event E4 **should be specifically excluded** from applying to "non-assessable amounts" distributed by trustees to beneficiaries, where such amounts are directly referable to the *Tax Break*.

Given the discrete nature of any amendment required to exclude CGT event E4, and the temporary nature of the legislation, we consider that any exclusion would be most usefully included in Division 41 (rather than in section 104-70 of Division 40). Although, either method could be equally effective in removing the potentially harsh consequences beneficiaries could be subjected to in the circumstances described above.

## 2. Treatment of sale and leaseback transactions

In its current form, the draft legislation does not provide taxpayers who enter into sale and leaseback transactions with certainty as to the application of the *Tax Break*. There are two particular aspects to this uncertainty.

Firstly, it appears that there may be circumstances where a newly acquired asset may not meet the definition of a "new asset"<sup>2</sup>, because such an asset is installed ready for use by the lessee under a sale and leaseback arrangement, prior to legal ownership of the asset passing to the lessor. For example, the *Tax Break* may be unavailable in situations where a new asset is acquired by a taxpayer and installed ready for use, just before it enters into a sale and leaseback of that asset. In such circumstances, there is a risk that when legal title to such an asset passes to the lessor under the arrangement, the asset may be considered "second hand" (as it was previously installed ready for use) and the *Tax Break* would therefore be unavailable. This would obviously be an anomalous outcome for an asset that is "new" by any usual meaning of the word.

Secondly, we do not believe that the current draft legislation makes it entirely clear as to the party entitled to the *Tax Break*, where the relevant asset is subject to a sale and leaseback arrangement. That is, while the draft legislation provides a general entitlement to the *Tax Break* for assets subject to sale and leaseback transactions (subject to our comments immediately above), in certain circumstances it is unclear whether the lessee or lessor will be entitled to the *Tax Break*. Such ambiguity increases the likelihood of lessee's and lessor's disagreeing over which party is entitled to the benefits of the *Tax Break*.

Therefore, to protect the availability of the *Tax Break* to sale and leaseback arrangements, and to provide certainty as to which party is entitled to its benefits, it may be useful to reproduce the sale and leaseback language from section 51AD(6) of the *Income Tax*

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<sup>2</sup> Refer to subsection 41-120(1)(e) of the Exposure Draft of the *Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009*.

*Assessment Act 1936 (ITAA 1936)*. That is, we suggest inserting the following language (again, taken from the section 51AD(6) exemption) into the draft legislation, as a new *section 41-120(4)* in order to clarify the outcome for sale and leaseback arrangements and to resolve the issues noted above:

For the purposes of paragraph (1)(e) [of section 41-120], an asset shall be taken not to have been, prior to its acquisition by you, owned, and used or held for use, by any other entity if:

- (a) the property was first used or held for use by the other entity at a time within 6 months before the acquisition of the property by you; and
- (b) at that time there was in existence an arrangement that the property would be sold to another person and leased by that person to the first-mentioned entity.

We believe that by adopting such language, the treatment of sale and leaseback arrangements would be enhanced, as the issues described above would be resolved in the following manner:

- Ensuring that the strict operation of the "new asset" test does not preclude parties who have entered into sale and leaseback transactions (with newly acquired assets), from the benefits of the *Tax Break*.
- Removing the ambiguity as to the party entitled to the *Tax Break*, by clearly allocating such rights to the lessor (noting that by removing this ambiguity, the parties will be able to transparently factor the benefits of the *Tax Break* into the pricing of the arrangement).

Further, an added benefit of adopting the language from section 51AD(6) for these purposes, is that its concepts are well known to tax professionals, the ATO and relevant industry participants.

### 3. **Recognised new investment amount – investment time**

We believe that there is strong policy rationale in extending the definition of "recognised new investment amount" to ensure that certain assets, due to the quantum of their cost and nature of the arrangements to which they are subject, are still entitled to the *Tax Break*.

That is, we believe that assets which have a significant lead time between their contract date and delivery date that may otherwise be precluded from the benefits of the *Tax Break* are specifically included. Such an issue is relevant because many large items of capital equipment (including, for example aircraft) can be subject to contract dates of up to 15 years prior to delivery.

Consequently, it is conceivable that assets subject to arrangements that require lengthy periods to negotiate, finance, construct and deliver the relevant asset could never qualify as a "recognised new investment amount", because either:

- The relevant contract is entered into before 13 December 2008, even though delivery occurs during the 2009 or 2010 income years; or
- The relevant asset is not installed ready for use by 31 December 2010.

For these reasons, we believe that the definition of "recognised new investment amount" should be extended to include certain assets (including aircraft) ordered prior to 13 December 2008, where first use of the assets occurs during the required period. Given that such arrangements normally relate to assets with a high value, an integrity measure could be included to ensure that the extended definition only applies to assets with a cost

in excess of (say) \$25 million. We believe that such an amendment will provide additional incentives not to postpone new capital expenditure and also to avoid penalising those industries whose assets are subject to the long lead times discussed above.

Further, we believe that these concessions are necessary because, to date, we have not seen a great deal of new investment as a result of the announcements. Indeed, some of the feedback that we have received from industry participants is that the changes have been ineffective in generating any additional demand for capital expenditure, in part due to the general feeling of uncertainty as to the application of the measures.

Therefore, we believe that the amendments we have suggested above, will not only remove some of the anomalous aspects of the draft legislation, but also improve the level of certainty as to the application of the measures, and therefore assist in fulfilling the stated policy objectives of the *Tax Break*.

If you have any queries, or would like to discuss any aspects of this submission, please do not hesitate to contact us.

Yours faithfully,

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