Australia’s (Latest) Tax Reform Foray:  
The Measures Affecting Entrepreneurial Activity  
Graeme S Cooper  
Melbourne University Law School

On 13 August 1997, to the surprise of many, tax reform was revived by the Coalition parties as the dominant element of their platform for the expected election. This came as shock to those who could remember the 1993 election, an election fought and lost by the Coalition Parties on a similar tax reform agenda. Once bitten, twice bitten? The Prime Minister’s statement announced that a review of the tax system would be undertaken, based around five principles:

1. No increase in the overall tax burden  
2. A major reduction in personal income tax, especially for families  
3. A broad based indirect tax to replace some or all of the existing indirect taxes  
4. Compensation for those deserving of special consideration  
5. Reform of Commonwealth/State financial relations.

This announcement was followed in early 1998 by a short booklet published by the Treasurer, The Australian Tax System — In Need of Reform and in August 1998 with the more detailed 208-page policy manifesto, Tax Reform: Not a New Tax, A New Tax System, known as the “ANTS Statement.” The miscellany of measures announced in that manifesto ranged over the entire tax system:

For personal income tax, the tax-free bracket would be increased and marginal tax rates reduced, costing about $AUS12b. Employee fringe benefits, taxed in Australia under an employer excise tax, would have to be reported (even though not taxed in the employee’s hands) for the purposes of various income-based surcharges.

The consumption tax regime would change markedly with the former wholesale sales tax replaced by a 10% VAT commencing on 1 July 2000 (generating $AUS12b more in revenue per annum), and all the revenue allocated to the States. The inter-generational issues arising from the transition would be managed by increasing pensions, and special one-off payments for some pensioners and self-funded retirees.

Aspects of the business tax base would also change. Various capital gains exemptions for small business would be consolidated and extended; several anti-avoidance provisions targeted at tax avoidance using trusts would be enacted; and the general anti-avoidance rules would be broadened.

In respect of corporate tax, it was proposed to tax trusts (currently transparent arrangements) as if they were companies; an equalization tax would be collected from the company on distribution of untaxed corporate profits; and there was the prospect of reducing the company tax rate from 36% to 30%, if savings in the tax base could be identified (most probably by decelerating the depreciation schedule).

Tax administration would also be revised. The annual prepayment of tax by the self-employed and retirees and the retrospective payment of tax by companies would both be abolished, and replaced with a single pay-as-you-go system.

Various State nuisance taxes would be repealed in light of the GST revenue.

The day after making its momentous announcement, and according to the prevailing wisdom after strenuous lobbying by business groups, the Government announced that all issues affecting the business tax base and the taxation of intermediaries would be referred to a
specially-created committee, the Review of Business Taxation, to be chaired by John Ralph, the CEO of a diversified industrial conglomerate in Australia.


In so far as one can discern themes and trends in the Report’s recommendations for entrepreneurs, the Report’s recommendations can be grouped into four main groups:

1. measures designed to relax certain tax compliance obligations for small businesses,
2. measures designed to preserve for the small business sector the value of some of the concessions in the current tax base which were to be repealed for large businesses,
3. measures which it was hoped would facilitate access to capital, and
4. a range of tax base concessions said to be designed to encourage entrepreneurial activity.

**1. Relaxing compliance obligations – Chapter 17**

One of the major systemic changes proposed by the Review, and accepted by the Government, was that a series of relaxed tax base rules be introduced for small businesses [Recommendation 17.1]. These measures, referred to collectively as the “Simplified Tax System” were proposed in order to reduce the compliance costs of small businesses. The elements of the simplified tax system are (a) cash accounting for the recognition of income and expenses, (b) a simplified depreciation regime (including a small business depreciation pool as against an individual asset regime), and (c) a simplified inventory accounting regime.

**1.1 Small business definition**

Small business eligible for STS treatment were defined as those with annual revenue under $AUS 1 million (and with less than 5% of their revenue from leasing activities). The Review felt that existing safeguarding provisions, such as the grouping provisions in States’ payroll tax legislation, or the capital gains tax grouping rules, could be used to ensure that larger businesses did not separate their operations into smaller businesses with under $1 million turnover. These provisions take the revenue of associated taxpayers (for example company subsidiaries or unincorporated businesses with a common controller) into consideration for the purposes of calculating thresholds. It was proposed that a reasonable person test should be used to determine if businesses are substantially independent. If businesses pass this test, they may still be permitted access to concessions even where they fail basic grouping tests.

After electing to participate in the simplified tax system, businesses will be allowed to remain under the regime until their average turnover for the current and preceding two years exceeded $1 million per annum. This measure was designed to allow for small annual fluctuations in turnover.

Further, businesses that leave the regime may return to it. Where businesses have elected to leave the system (rather than no longer meeting its eligibility requirements), they must
demonstrate a commercial case for the reversal of their categorisation. Businesses that have had to leave because of increased turnover must demonstrate a substantial change to the nature of their business leading to reduced turnover.

The leasing exclusion is designed to prevent businesses in the STS regime from transferring the benefits of faster depreciation rates to lessees outside the system. The level is set at 5% to allow some temporary and minor leasing income.

1.2 Cash accounting regime

One of the STS benefits is access to cash accounting for recognising business income and expenses. Cash accounting applies to most income and expenses other than, depreciables, inventory, capital gains tax assets and liabilities, assets and liabilities in externally-managed projects, various financial assets and liabilities, and various non-routine leases and rights [Recommendation 17.2].

The STS regime also would not apply to prepayments for the provisions of services or products over a period exceeding twelve months or ending after the next income year. This last limitation is designed to avoid the use of tax shelter schemes, while giving most small business the same benefits as individual taxpayers by not requiring them to account for assets that have not yet been received.

This change is designed to benefit small business by lending symmetry to the presently asymmetrical treatment of payments and receipts, providing clarity in the law associated with the timing of income receipts, and making it possible to relate tax liability to the tax flow of a business.

1.3 Accelerated depreciation for tangible depreciable assets

One of the major design issues for the Review of Business Taxation was to manage the reduction of the corporate tax rate from 36% to 30% within an overall “revenue neutrality” constraint. This was achieved by reducing the depreciation rates [Recommendation 8.1]. But in order to placate the small business and farming lobbies, it was proposed that they would be immunised from these changes [Recommendation 17.3]. The way in which they were immunised is discussed below.

1.4 Simplified inventory regime

The remaining benefit for businesses electing into the STS regime was simplified stock-taking rules. It was recommended that (a) where the total value of a business’ inventory is less than $5,000, or (b) the change in value of its inventory during the year is less than $5,000, no change in the value of inventory over the year need be accounted for [Recommendation 17.4].

Because of the cash accounting regime, which comes as part of the STS, businesses would recognise sales and purchases of inventory only when cash is received or applied, not when purchase or sale of stock occurs on credit.

The Review said these measures would have a “huge beneficial” impact on taxpayers because over 75% of small business taxpayers would not have to account for trading stock for the purposes of preparing their annual tax return.

1.5 Other measures

Some of the other proposed reforms (such as the capital gains tax reforms discussed below) were also said to reduce the taxpayer’s compliance costs by simplifying the procedures applicable to accessing various exemptions.

2. Preserving existing concessions – Chapter 4

Another way of viewing the simplified depreciation regime and other measures is that they were announced in order to preserve the value of various concessionary regimes already in the
tax base. The carve-out from many measures of small businesses and farmers speaks volumes.

2.1 Protection from the Tax Value Method

One of the more frolicsome aspects of the Review was its decision to recast the terminology of the income tax base [Recommendation 4.1]. Rather than applying terms such as “income” and “expenses” to cash flows, we will have to use a new nomenclature based on the “tax value” of assets and liabilities.

Even though the Review argued that the measure was largely cosmetic, again, it was thought important that small business be excluded from them [Recommendation 4.4]. The Review asserted that, “most taxpayers operating small businesses will feel little practical impact from the new approach because of the Review’s recommendations allowing them to opt into the simplified tax system (STS) described in Recommendation 17.1.”

2.2 Preserving accelerated depreciation

While large businesses would cease to enjoy the benefit of the accelerated deprecation schedule, the Review proposed that taxpayers in the STS regime would largely retain their current depreciation rates for lasting tangible assets [Recommendation 17.3].

The Review proposed (again) that small businesses adopt a pooling system for calculation of depreciation. A similar measure had been introduced in the early 1990s – it generated no interest from business. Under the new regime, it was proposed that there would be a single pooling arrangement for all tangible depreciable assets costing more than $1,000 with an effective life of less than 25 years. Items costing less than $1,000 would remain eligible for immediate tax write-off.

The collection of assets in the pool would be depreciated as a single asset at the rate of 30% per annum. First-year conventions would be enacted. Net sale proceeds would be deducted from the written down value of the pool, and when the value of the pool balance fell below $1,000, the remainder be immediately deducted. Items with an effective life exceeding 25 years will be subject to effective life depreciation under the general depreciation schedule.

In addition, the Review recommended that arrangements for assessing the taxable assets used partially for private purposes should be streamlined.

It was felt that these two measures would benefit small business taxpayers by removing the requirements for asset-by-asset record-keeping. It also combined the existing balancing charge and capital gain calculations by deducting net sale price of assets from pool values (and in the case where net sale price exceeds pool value, including this amount as income). Finally it was said to reduce the compliance costs for taxpayers by eliminating the need for continued depreciation calculations where the asset’s value is non-material (i.e., under $1,000).

2.3 Preserving pre-payment benefits

The rules on pre-payments in Australia’s income tax have always been rather slipshod. Prior to the Review, a ‘13-month’ rule applied to deny a deduction for a pre-payment, but only where that payment would still be securing a benefit for the taxpayer more than 13 months after incurring the payment. Pre-paid rent, interest and insurance premiums were standard examples.

The Review recommended that this rule be replaced by a stricter pro-rating rule wherever the benefits of the pre-payment lasted beyond the current income year. Again, small businesses were to be excluded from this measure if they elected into the STS regime [Recommendation 4.6].
Three sets of recommendations were said to be designed to enhance the access of local firms to business capital, all operating by enhancing the after-tax return to investors. One measure was targeted to foreign capital providers and the others to all capital providers.

### 3.1 Foreign venture capital tax relief

At present, Australia exempts from Australian (withholding) tax, payments of interest and dividends to investors where the investor is exempt from tax in its country of residence. This exemption is typically used by foreign pension funds. No similar exemption existed to exempt from capital gains tax the gains made by foreign tax exempt investors. The Review recommended that non-resident tax-exempt pension funds resident in certain listed jurisdictions should be given an explicit exemption from capital gains tax on gains derived from the disposal of investments in new equity in eligible venture capital projects [Recommendation 19.1].

As drafted, the exemption would be restricted to pension funds, and only to funds resident in certain named countries. Pension funds from other countries could become eligible, "provided those countries exempt only bona fide pension funds." The exemption would only apply to at-risk investments held by the investor for 12 months or more (the definition of ‘patient capital’ for these purposes), in eligible venture capital projects, where the receiving entity has gross assets of less than $50 million and is not primarily engaged in property development.

The Review argued that increased international investment would have a direct effect on levels of local investment and would be a catalyst for increasing the volume of high risk investments. The recommendation arose from the Committee’s perception that there is a shortage of venture capital funding in Australia. This shortage was said to be caused in part by the present capital gains tax regime, which should be made more competitive with the capital gains tax regimes of other jurisdictions.

The Report suggested the effectiveness of these measures should be reviewed in five years. In particular, a further review should consider whether there has been a net addition to total investment as a result of the investment incentives, and whether the list of the jurisdictions to which the incentives apply should change.

### 3.2 Pooled development funds

The Review also suggested the government might reassess whether access to the Australia’s pooled development fund (PDF) regime should be made easier. This regime currently offers investors in qualifying investment funds an exemption from income tax on dividends and from CGT on the sale of their investments. The PDF itself pays tax at 15% on income from its investments in small businesses and 25% on income from other permitted investments. PDFs can only invest by way of fresh equity subscription in small businesses with total assets of less than $50 million whose primary activities are not retail operations or property development. The PDF must take between 10-30% of the target business.

In particular, the Review suggested it might be worthwhile to review both the requirement that pooled development funds invest in new equity and the 30% limitation on individual holdings in a target business.

### 3.3 Capital gains tax reductions

The Review also recommended that the effective tax rate on capital gains derived by individuals and Australian pension funds from assets held for more than 1 year should be reduced by 50% in the case of individuals and by 33% in the case of pension funds [Recommendation 18.1]. The reduction of capital gains tax rates was said to be designed to provide a further incentive for investing. Again, ‘patient capital’ was defined by implication as investments held for more than 1 year.
In order to finance the reduction in the CGT rate, the existing averaging regime (designed to eliminate the bunching effect for capital gains income) was abolished. The Committee suggested that the averaging provisions be eliminated since at present some asset holders use these provisions to reduce their capital gain tax to zero, while others cannot engineer the same benefits, producing an unintended and inequitable result.

Furthermore, adjustments were recommended to the current measures that index gains for the effects of inflation. Taxpayers were offered a choice either to pay capital gains tax at normal rates on their indexed gains (with indexation frozen at 30 September 1999), or to pay tax at reduced rates on their realised nominal gains from the disposal of an asset. The abolition of indexation was recommended by the Review because, while it was acknowledged that indexation provided a significant reduction in the effective capital gains tax rate, this fact was not widely recognised by investors, particularly foreign investors. The Review felt that this misperception would be difficult to correct, and that a more transparent concession similar to those used overseas would be more attractive to investors.

These recommendations were said to be designed to invigorate Australian equities markets, increase participation by individuals, and achieve a better allocation of capital resources, by increasing turnover and asset realisation. The Review decided not to opt for a UK-style system of stepped CGT rates (which gives greater relief the longer an asset is held) for two reasons. First, it was said, a stepped scale rates system may have the side effect of locking investors into sub-optimal positions. Secondly, it was said, start-up ventures frequently require capital restructuring shortly after start-up in order to fund further development, and stepped rate scales don’t encourage the necessarily shorter term of investment in such ventures.

Submissions to the Review expressed some concern about the impact of the removal of capital gains indexation upon farmers. They argued that in many cases, capital gains only keep pace with inflation. In response to this concern, the Review recommended that the indexation inherited from the high inflation period of the 1980s be preserved under the new system. This would allow farmers in particular to enjoy the benefits of indexation. This response was premised on the assumption by the Review that inflation would be lower in the future than in periods like the 1980s. These lower inflation rates would render a 50% capital gains discount more attractive than indexation. The Review also argued that the suggested small business capital gains exemptions and rollover relief mitigate the tax burden even more. Moreover, they argued that the expansion of the small business exemption from goodwill gains to all gains would be of particular relevance to farmers.

4. Concessions for entrepreneurial behaviour – Chapters 17-19

4.1 Consolidating and expanding small business CGT concessions

Prior to the Review, Australia’s CGT rules contained three major small business concessions. The first was a reinvestment rollover deferring the taxation of a gain made on the disposal of an asset where a small business reinvests the gain in a replacement asset. The second excluded from tax 50% of a capital gain made on the sale of a small business where the gain was made on the sale of the business’ goodwill. The third excluded from tax all the gain made on the disposal of an asset if the taxpayer elected to treat the gain as subject to the retirement income regime.

The Review recommended that the second regime be replaced with a single broader exemption from tax of 50% of any capital gain arising on the disposal of any of the “active assets” of a small business [Recommendation 17.5]. Eligibility for this exemption should be determined by the same provisions governing eligibility for capital gains tax small business rollover and retirement exceptions.
It was apparently intended that this 50% exclusion would accumulate upon the 50% CGT rate for individuals discussed above. This would mean that taxpayers who operated their businesses as partnerships or sole traders would enjoy a 75% exemption of CGT on the disposal of active assets. The remaining 25% would be taxable but might be rolled over or enjoy the retirement income exemption. That is, the small business retirement exemption and rollover measures would continue to be available to capital gains remaining after the application of the new small business active assets measures.

This measure was said to be designed to increase incentives in the sector and increase flexibility for small business taxpayers. It was also said to rationalise the parallel provisions by applying the same access tests consistently.

4.2 Scrip-for-scrip rollover relief

The Review also recommended that optional rollover relief from CGT be provided where a taxpayer exchanges its shareholdings in one company (or units in fixed trusts) for shares in another in the course of a takeover [Recommendation 19.3]. It was thought that this was an inappropriate point for taxing any implicit gains that would be recognised on the sale of the first shareholding.

In the original recommendation, this relief would only apply in the case of takeovers that involve at least one widely-held entity – this requirement was abandoned by the Government. The Review rejected the submission that relief should be offered to widely held entities which merge, to improve overall efficiency. The recommendation for relief was limited strictly to the exchange of equity interests, and not to any cash or other property that might be paid. It was also recommended that the measure only apply where the acquiring entity secures at least 80% of the voting interests in the target through a takeover scheme. The rollover relief would not apply to non-residents unless their replacement membership interest would be liable to Australian CGT when sold.

Where membership interests which preceded capital gains taxation are replaced, the replacement membership would be brought into the CGT system, and the acquisition value of the replacement membership interest will be its market value at the time of acquisition.

These suggestions for reform were prompted by the concern that current capital gains tax arrangements impede corporate acquisition activity by forcing acquiring entities to pay a premium to persuade equity holders with potential CGT liabilities to accept their offer. This measure was also said to be designed to encourage start up and innovative enterprises to remain in Australia, by avoiding the situation where entrepreneurs face capital gains tax liability in a scrip-for-scrip transaction when where no cash payment is received. The committee felt that this scenario encourages businesses to locate elsewhere and reduces our number of local success stories, further decreasing the chance of investment.

The Review also recommended that rollover relief be available for business demergers or deconsolidations.

As in the case of the investment incentives for venture capital, the committee proposed that the impact of these provisions should be reviewed after 5 years of operation.

5. After Ralph

After the Government’s election victory in October 1998, a furious legislative program of over 30 amending Bills followed in 1999 and 2000 in order to give effect to the original ANTS agenda, and the subsequent recommendations of the Review. Part of the unseemly haste was created by the three year time horizon of the Australian Parliamentary cycle, with the next federal election due by October 2001.

While many of the measures recommended in the ANTS Statement and by the Review have now been enacted, the extent of the reforms and the accumulation of change have led to a
serious level of tax fatigue on the part of taxpayers and their advisors. There is now some
doubt whether the remainder of the Review’s unenacted recommendations will be pursued by
this Government.

The Government’s disillusionment with tax reform has been produced by at least three
factors. The first was an unfortunate over-zealousness on the part of the Revenue in setting
up its new reporting requirements – after two quarterly reporting cycles, the Government has
now had to withdraw the original forms and instruct the Revenue to be less ambitious. The
second has been a concerted lobbying effort on the part of affected groups within the
Government’s business constituency against some of the recommendations, drawing attention
to bad policy outcomes, poor drafting, unintended consequences and so on. Finally, the
federal Government parties have been resoundingly defeated in two State elections already in
2001. The perception now is that the looming federal election and the general voter
dissatisfaction with tax reform have caused the Government to lose its appetite for further
reform.

Many significant measures such as the measures to tax trusts as companies, the proposed
consolidation system, and the much-vaunted “tax value method” have not been advanced and
are now likely to be shelved so that the Government can focus on more electorally appealing
policies.
Appendix
Extracts of Recommendations
Review of Business Taxation, *A Tax System Redesigned* (September, 1999)

4.4 **Determining tax values for individual taxpayers**
That individual taxpayers be required to determine tax values for the following assets and liabilities …
(ix) business assets and liabilities of small business taxpayers who do not elect to use the simplified tax system in accordance with Recommendation 17.1.

4.6 **Prepayments**
Repeal of 13-month rule
(a) That the existing provision allowing immediate deduction for advance expenditure relating to the provision of services within 13 months be removed from 1 July 2000.
Apportionment principle
(b) That, for taxpayers on both sides of the transaction, advance expenditure incurred (‘prepayments’) be allocated over the income years to which the expenditure relates.
New 12-month rule for taxpayers accounting on cash bases
(c) That most prepayments of no more than 12 months be brought to account in the year of payment or receipt for taxpayers calculating taxable income using:
   (i) a cash basis treatment (Recommendation 4.4), or
   (ii) the simplified tax system (Recommendation 17.2).

8.1 **Removal of accelerated depreciation**
Replacement with an effective life basis
(a) That current accelerated depreciation arrangements be replaced with a system under which the rates of taxation depreciation for depreciable assets acquired after the commencement date be determined by the effective life of the asset in line with Recommendation 8.5.
Application from date of announcement
(b) That accelerated depreciation no longer apply to assets acquired under contracts entered into after the date of announcement.
(c) That assets acquired before the date of announcement retain their existing treatment in respect of the rate of write-off.
Simplified arrangements for small business
(d) That paragraphs (a) to (c) not apply to relevant depreciable assets of small businesses that decide to use the simplified depreciation system under Recommendation 17.3.

17.1 **Simplified Tax System (STS) for small business**
That in order to reduce the compliance costs faced by small businesses, a small business with:
   an annual turnover or annual receipts of less than $1 million, exclusive of Goods and Service Tax, and
   which derives less than 5 per cent of its income from a leasing activity,
be able to elect to be taxed under the Simplified Tax System (STS), consisting of:
(i) a cash accounting regime — for recognising business income and day-to-day expenditure as an alternative to an accruals based regime;
(ii) a simplified depreciation regime — including a small business depreciation pool for most tangible depreciable assets, as an alternative to an individual asset regime based on effective life; and
(iii) a simplified trading stock regime — as an alternative to an annual requirement for stocktaking and stock valuation.
17.2 Cash accounting for small business
That as part of the simplified tax system, an eligible taxpayer electing to use that system adopt a cash basis to account for their business income and their day-to-day expenditure, except in relation to:

(i) depreciable assets subject to write-off for taxation purposes — covered by the simplified depreciation regime (see Recommendation 17.3);

(ii) trading stock on hand where the change in the value from the opening stock value in the initial base year (or a substituted base year) exceeds $5,000 — covered by the simplified treatment for trading stock (see Recommendation 17.4);

(iii) all assets and liabilities (including prepayments) relating to participation in a project or arrangement, managed by another person or entity, in which a number of taxpayers individually participate;

(iv) prepayments where the payment relates to the provision of services or products over a period:
   - exceeding twelve months; or
   - ending after the next income year;

(v) assets in which a gain or loss is taxed on realisation;

(vi) financial assets and liabilities that would be taxed on an accruals basis in accordance with Recommendation 9.2 and that have a term of one year or more where the rate of return applicable to any effective discount or premium is more than 1 per cent per annum, compounded annually;

(vii) financial assets and liabilities subject to market value election in accordance with Recommendation 9.1; and

(viii) non-routine leases and rights (see Recommendations 10.1 to 10.13).

17.3 Simplified depreciation regime for small business
That as part of the simplified tax system, an eligible taxpayer electing to use that system adopt a simplified depreciation regime consisting of:

(i) where the cost of a tangible depreciable asset is less than $1,000 — immediate write-off;

(ii) for all other tangible depreciable assets with an effective life of less than 25 years — a pooling arrangement, with depreciation at the rate of 30 per cent (declining value basis); immediate write-off of the pool balance when less than $1,000; and streamlined arrangements for assets partially used for private purposes; and

(iii) for tangible depreciable assets with an effective life of 25 years or more — effective life depreciation under the general depreciation regime (see Recommendation 8.2).

17.4 Simplified treatment for trading stock for small business
That as part of the simplified tax system, an eligible taxpayer electing to use that system adopt a simplified taxation treatment for trading stock under which:

(i) where the value of opening stock on hand is no greater than $5,000 — no amount need be included in taxable income where it can be reasonably expected that the value of closing stock on hand is also no greater than $5,000;

(ii) where the value of opening stock on hand is greater than $5,000 — changes in the value of the physical stock need not be accounted for where it can be reasonably expected that the difference between the value of the physical closing stock and the value of the physical opening stock is not more than $5,000; and

(iii) where the difference between the closing stock value and opening stock value in the base year (or substituted base year) exceeds $5,000 — the amount of the change be included in taxable income and a new base year opening stock value be established.

17.5 Capital gains tax — small business
Rationalising goodwill exemption and small business concessions
(a) That the existing 50 per cent Capital Gains Tax (CGT) goodwill exemption for small business be replaced with a small business assets exemption of 50 per cent of all capital gains arising on the disposal of active assets subject to capital gains treatment.

Eligibility criteria for replacement exemption
(b) That the provisions in the law used to determine eligibility for the CGT small business rollover and retirement exemptions be applied to determine eligibility for the small business assets exemption.

Additional concessions
(c) That for taxpayers who operate small businesses through partnerships or as sole traders, the 50 per cent exemption in paragraph (a) apply to the component of the capital gain remaining after the reduction in the gain from either the proposed 50 per cent exclusion or the frozen indexation amount — see Recommendation 18.2.

17.6 Flexible access to CGT relief
That the small business rollover and the retirement exemption continue to be available, as appropriate, in relation to gains remaining after application of the new small business assets exemption.

18.1 Capital gains averaging and indexation
Averaging abolished from date of announcement
(a) That, from the date of announcement, averaging of capital gains cease in respect of disposals of assets contracted for from that date.

Indexation frozen at 30 September 1999 for all taxpayers
(b) That for capital gains realised by all taxpayers — including entities — indexation adjustments to asset tax values cease after applying the index for the quarter ending 30 September 1999 — with indexation thereafter frozen at the level reached at 30 September 1999.

18.2 Capital gains taxation for individuals
Option for individuals to include half of realised nominal gains in income
(a) That if, after 30 September 1999, an eligible asset (see Recommendation 4.10) is disposed of directly by an individual, the individual be able to choose to be taxed on the basis of half of the realised nominal gain (that is, without any indexation) being included in the individual’s taxable income — provided that the asset has been held by the individual for a year or more at time of disposal.

Option for individuals to include gains net of frozen indexation
(b) That in relation to such disposals, an individual may alternatively choose to have included in taxable income the whole of the gain between the realised price of the asset and its indexed cost base as frozen at 30 September 1999.

18.3 Capital gains taxation for complying superannuation and related funds
That for all disposals after 30 September 1999, complying superannuation and related funds be allowed to include in their taxable income, in respect of the realisation directly by the fund of assets held for a year or more:
(i) either two-thirds of the nominal capital gain; or
(ii) the whole of the difference between the realised price of the asset and its indexed cost base as frozen at 30 September 1999.

18.4 Treatment of capital losses
That for all disposals after 30 September 1999 of eligible assets (see Recommendation 4.10) held for a year or more at the time of disposal:
Capital losses able to be offset in any order
(i) capital losses be offset against capital gains in any order;
Where offset against gains net of frozen indexation
(ii) where taxpayers recognise gains net of frozen indexation — losses be offset against those gains net of frozen indexation;
Where offset against gains not based on frozen indexation
(iii) where taxpayers choose not to recognise frozen indexation or no such indexation is available — losses be offset against the full capital gain before it is reduced by any exclusion amount; and

Residual capital gains
(iv) where a residual gain remains after extinguishing all capital losses available — the remaining gain:

either be reduced by the relevant exclusion amount for gains (where no indexation is claimed); or
be included in taxable income without further reduction if determined by reference to frozen indexation.

18.5 Treatment of revenue losses
That revenue losses be offset against capital gains realised after 30 September 1999 on eligible assets:
(i) after capital losses have been applied (Recommendation 18.4); and
(ii) after any relevant percentage reduction is applied (Recommendations 18.2 and 18.3).

18.6 Treatment of capital gains from trusts and CIVs
Trusts to be subject to entity taxation
(a) That for trusts that will be subject to the entity tax regime from 1 July 2000:
Gains realised on assets disposed of before 1 July 2000
(i) for gains realised before 1 July 2000 on assets acquired before then, the trust be allowed the optional treatment of capital gains available for individuals — Recommendation 18.2(a) and (b); and
Gains realised on prior assets from 1 July 2000
(ii) for gains realised at any time after 1 July 2000 on assets held at the time of announcement, the trust be allowed the optional treatment of capital gains available for individuals — Recommendation 18.2(a) and (b) — with the component of capital gains freed from tax treated as contributed capital, as set out in Recommendation 11.8.

Trusts not to be subject to entity taxation
(b) That for trusts that will not be subject to the entity tax regime from 1 July 2000:
Collective investment vehicles — CIVs after 1 July 2000
(i) before 1 July 2000, individuals and complying superannuation and related funds be allowed the optional treatment available under Recommendations 18.2 and 18.3 for gains realised, and distributed, by CIVs on assets held for a year or more;
(ii) from 1 July 2000, individuals and complying superannuation and related funds be allowed to include in their taxable income half and two-thirds, respectively, of the nominal capital gains realised, and distributed, by CIVs (see Recommendation 16.4) on assets held by the CIV for a year or more at time of disposal (with gains on such assets not being able to be included net of frozen indexation); and

Excluded trusts
(iii) for gains realised on disposals after 30 September 1999 by excluded trusts — Recommendation 16.10(a) — those gains be taxed according to the treatment proposed in Recommendation 16.10(b).

19.1 Targeted tax relief for venture capital investment
Capital gains tax exemption
(a) That, from the date of announcement, non-resident tax exempt pension funds from certain jurisdictions (or limited partnerships of such funds) be allowed an explicit exemption from income tax on gains derived from the disposal of investments in new equity in eligible venture capital projects.

Scope of exemption
(b) That the exemption be restricted to:
   (i) exempt pension funds from the United States, the United Kingdom, Japan, Germany, France and Canada — from the date of announcement;
   (ii) other countries’ pension funds provided those countries exempt only bona fide pension funds — on or after the date of effect specified in amending legislation;
   (iii) investments which are at risk and held by the investor for a period of not less than 12 months; and
   (iv) investments in an eligible venture capital project — defined as one where the receiving entity:
       has gross assets not exceeding $50 million (including the new investment); and
       does not engage in property development as its primary activity.

19.2 Effectiveness review for venture capital relief

Review after five years
(a) That the effectiveness of the concession proposed in Recommendation 19.1 be reviewed five years after its introduction.

Investors to supply annual information
(b) That to facilitate the review, investors be required:
   (i) to register with, and provide information to, the Pooled Development Fund (PDF) Board when the investment is made; and
   (ii) to provide an annual return indicating, for example, the amount invested and any distributions made.

19.3 Rollover relief for takeovers

Takeovers to be by widely held entities
(a) That, commencing from the date of announcement, optional rollover relief from taxation of capital gains be provided for exchanges of membership interests in companies or fixed trusts in takeovers involving at least one widely held entity.

Criteria governing entities and members
(b) That the rollover relief apply for takeovers where the acquiring entity acquires or increases its holding to at least 80 per cent of the voting interests in another entity through a takeover scheme.

(c) That the rollover relief not apply to non-residents unless:
   (i) they hold membership interests in resident entities; and
   (ii) where a previous liability for tax on capital gains existed, the replacement membership interest would also be liable for tax on capital gains.

Treatment of pre-CGT interests
(d) That for membership interests qualifying under paragraphs (a), (b) and (c) and acquired in exchange for a membership interest acquired pre-CGT:
   (i) the replacement membership interest not attract capital gains exempt status; and
   (ii) the acquisition value of the replacement membership interest:
       be its market value at the time that the membership interest is acquired; and
       become its initial tax value.

19.4 Rollover relief for business demergers or deconsolidations

Demerger not to produce taxing event
(a) That, where a widely held entity splits its operations into one or more new entities and issues membership interests in these entities to the original members in the same nature and proportion as their original membership interest:
   (i) there be no tax consequences for the members; and
   (ii) the tax value of the membership interest be spread across the new and old interests.

Tax values for pre- and post-CGT interests

(b) That in the case of:
   (i) an initial pre-CGT membership interest — the tax value be the market value of the new equity interests immediately after their acquisition; and
   (ii) post-CGT membership interests — the tax value of the new membership interest be determined by apportioning the old tax value across the new membership interest in proportion to the market value of the new membership interest.

Date of effect
(c) That this measure be implemented with the same date of effect as the entity tax regime and related measures proposed by the Review.

19.5 Effectiveness review for scrip-for-scrip relief
That the effectiveness of the concessions proposed in Recommendations 19.3 and 19.4 be reviewed after about five years of operation.