



## THE TAX INSTITUTE

THE MARK OF EXPERTISE

23 September 2016

Mr Mark Fitt  
Committee Secretary  
Senate Economics Legislation Committee  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

By email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Mr Fitt,

### **Inquiry into Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016**

The Tax Institute thanks the Senate Economics Legislation Committee (**Committee**) for the invitation to make a submission in relation to the *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016 (Bill)*.

The Bill reduces the corporate tax rate for small businesses with an aggregated turnover of less than \$10 million to 27.5% from the 2016-17 income year through to the 2023-24 income year and then progressively lowers the corporate tax rate for all corporate tax entities to 25% to the 2026-27 income year. It also makes amendments to the tax discount available to unincorporated small businesses and ensures small businesses with an aggregated turnover less than \$10 million can access most of the small business tax concessions.

While we are broadly supportive of the measures contained in this Bill, our submission focuses on the main consequential amendments made to the imputation rules contained in Schedule 4 of the Bill. We refer to the measure entitled *Ten Year Enterprise Tax Plan – reducing the company tax rate to 25 per cent* contained in the 2016-17 Federal Budget. With respect to the effect of this measure on the imputation system, we note that the policy intention is that:

Franking credits will be able to be paid in line with the rate of tax paid by the company making the distribution<sup>1</sup>.

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<sup>1</sup> 2016-17 Federal Budget, Budget Paper No. 2, Part 1: Revenue Measures under the sub-heading 'Treasury'.

It is not clear to us what rate of tax the Government intends should be applied to frank retained earnings when they are paid out as dividends by a corporate tax entity that may experience tax rate changes during the period of transition from a corporate tax rate system that has two tax rates we currently have through to a corporate tax rate system with only one rate by 2023-24.

It is unclear from the policy statement whether the government intends that a company will be able to frank dividends based on the corporate tax rate they have paid, that is the rate paid in the past, or based on the rate that will be paid in the current income year.

The term 'corporate tax rate for imputation purposes' is being inserted into the law<sup>2</sup> which provides a means of determining which corporate tax rate to apply by reference to a corporate tax entity's aggregated turnover for the current income year and the previous income year. However, it does not shed a great deal of light.

The Explanatory Memorandum to the Bill (**EM**) is also unclear as to what the Government intends. For example, in the 'Comparison of key features of new law and current law' table at pages 11 – 13 of the EM, it is noted as the explanation for the new law that:

The maximum franking credit that can be allocated to a frankable distribution paid by a corporate tax entity will be based on a tax rate of 27.5 per cent.

However, if the entity's aggregated turnover for the prior income year is equal to or exceeds the aggregated turnover threshold for the current income year, then the maximum franking credit that can be allocated to a frankable distribution paid by the entity will be based on the headline corporate tax rate of 30 per cent<sup>3</sup>.

The draft law appears to operate such that if the corporate tax rate paid in the previous income year is higher than the rate that applies in the current year, the entity will only be able to frank dividends to the extent of the lower corporate tax rate. This would have the effect of 'trapping' franking credits in the entity.

Pitcher Partners, the accounting firm, has published an example on their website which demonstrates this outcome (included in the Appendix). In our view, this appears to give rise to an anomalous outcome where potentially taxpayers may be worse off.

It is our view that the correct policy outcome should be to permit an entity to frank dividends at the rate of tax a corporate tax entity has paid consistent with the broader imputation credit system. However, this does not appear to be how the provisions in the Bill would work.

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<sup>2</sup> See Item 28 of Schedule 4 to the Bill

<sup>3</sup> See page 13 of the EM

We note that paragraph 1.29 of the Explanatory Memorandum to the *Tax Laws Amendment (Small Business Measures No.1) Bill 2015* which introduced the 28.5% corporate tax rate for corporate small business entities stated that:

The term of **corporate tax gross-up rate** has been introduced to simplify the formulas applied in respect to the imputation system and to reference the 'standard corporate tax rate' to ensure that the 30 per cent rate remains unchanged.

If this is being forgone as part of the cost of the overall reduction of the corporate tax rate, this should be expressly stated rather than being implied.

We recommend that the Committee consider whether the appropriate outcome for corporate tax entities that may be subject to both corporate tax rates during the period of transition should be the same as a corporate tax rate system that has only one rate.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely



**Arthur Athanasiou**  
President

## Appendix – Extract from Pitcher Partners website

(<http://www.pitcher.com.au/news/transitional-tax-cuts-leave-sme-owners-paying-more-tax>)

The following table explains the increase in the effective tax rate. The top marginal tax rate has been used to keep the example simple, however the same issue arises for all marginal rates ...:

		Existing rules		Proposed rules	
		2015/16	2016/17	2015/16	2016/17
<b>Profit before tax</b>		1,000,000		1,000,000	
<b>Tax (@ 30%)</b>	<b>[A]</b>	300,000		300,000	
<b>Profit after tax</b>		700,000		700,000	
<b>Dividend paid (franked component)</b>			700,000		700,000
<b>Franking credit</b>			300,000		265,517
<b>Total taxable dividend</b>			1,000,000		965,517
<b>Individual tax (@ 49%)</b>			490,000		473,103
<b>Individual tax after franking offset</b>	<b>[B]</b>		\$190,000		207,586
<b>Total tax by company and individual</b>	<b>[A+B]</b>		<b>490,000</b>		<b>507,586</b>
<b>Effective tax rate on profit (\$1M)</b>			<b>49.00%</b>		<b>50.76%</b>
<b>Additional tax %</b>					1.76%
<b>Additional tax amount</b>					17,586