

**Submission to the ATO: Enterprise Tax Plan**

**Base Rate Enterprises Bill 2017**

29 September 2017

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Dear Sir/Madam,

The IPA is pleased to submit a submission on Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017. We welcome the Government providing more clarity around eligibility to the lower corporate tax rate which has been the subject matter of much uncertainty. A two tiered company tax rate system unfortunately does create more complexity in the tax system but the benefits to the economy of lower corporate tax rates on small corporate tax entities will far exceed any additional compliance costs. Advisers will need to acquaint themselves with a new concept of base rate passive entity income to determine eligibility for the lower company tax rate.

The Institute of Public Accountants (IPA) is one of the three legally recognised professional accounting bodies in Australia. The IPA has been in operation for over 90 years and has grown rapidly in recent years to represent more than 35,000 members and students in Australia and in more than 80 countries. The IPA has offices around Australia and in London, Beijing, Shanghai, Guangzhou and Kuala Lumpur. It also has a range of partnerships with other global accounting bodies. The IPA is a full member of the International Federation of Accountants and has almost 4,000 individual accounting practices in its network, generating in excess of $2.1 billion in accounting services fees annually. The IPA’s unique proposition is that it is for *small business*; providing personal, practical and valued services to its members and their clients/employers. More than 75 per cent of IPA members work directly in or with small business every day.

As part of the Government’s Enterprise Tax Plan, the corporate tax rate for small corporate tax entities has been cut to 27.5 per cent. The turnover threshold that applies for a corporate tax entity to qualify for the lower corporate tax rate will increase annually from $10 million in the 2016-17 income year to $50 million in the 2018-19 income year. The Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017 aims to clarify that corporate tax entities with predominantly passive income cannot access the lower corporate tax rate before 2023-24 when the tax rate should be 27.5 per cent for all companies. The Bill amends the *Income Tax Rates Act 1986* to ensure that a corporate tax entity will qualify for the lower corporate tax rate during this period only if:

* the corporate tax entity carries on a business in the income year;
* the aggregated turnover of the corporate tax entity for the income year is less than the aggregated turnover threshold for that income year; and
* the corporate tax entity does not have passive income for that income year of 80 per cent or more of its assessable income for that income year.

In this context, passive income includes (but is not limited to) dividends, rent, interest, capital gains and royalties. The proposed measures will also classify amounts that flow through partnerships and trusts as passive income to the extent that it is attributable to passive income. Passive income will not include distributions from partnerships and trusts where the partnership or trust carries on active trading business.

Whilst the law has been enacted to give small business companies a tax rate reduction with effect from the 2016-17 income year, there has been a lot of confusion around which entities might actually qualify for the lower tax rate. The uncertainty has arisen mainly due to whether a company is considered to be carrying on a business. It is imperative that a company knows what its tax rate is according to the law. Not only is this important for when the time comes to lodge its income tax return and pay its income tax for the year, but for purposes of working out the appropriate franking rate for any distributions it makes to its shareholders during the year. Getting the tax rate wrong can create downstream implications for its shareholders who may need to amend personal tax returns to reflect the correct franking distribution rate on distributions already received.

In addition to meeting the relevant aggregated turnover threshold, it is a requirement that a company carry on a business in order to qualify for the reduced company tax rate. Furthermore, in working out a company’s aggregated turnover, it is necessary to determine total ordinary income that the company (and its connected or affiliated entities) derives in the income year in the “ordinary course of carrying on a business”.

Once it is established that a company is carrying on a business (no matter how small or large) and meets the relevant aggregated turnover threshold, all of the company’s taxable income (not just that derived in the ordinary course of carrying on a business) is subject to the lower tax rate.

Whether or not a taxpayer is carrying on a business is a question of fact and degree. It requires a weighing up of various indicia. Judicial decisions often cite the following indicia:

* The nature of the activities undertaken and whether they have the purpose of profit-making
* Repetition and regularity of the activities
* Organization of its activities in a businesslike manner
* The keeping of books and records and the use of systems
* The volume of the operations and the amount of capital employed

It has been generally accepted that purely passive investment activity may not amount to the carrying on of a business. For companies however it does not mean that passive investment activity will always never constitute the carrying on of a business. When applying these factors to companies, the ATO in its guidance material has taken the view that where a company is established or maintained to make profit or gain for its shareholders (and has a prospect of profit), prima facie position it is likely to be carrying on business. The ATO maintains this view even if the company only holds passive investments and its activities consist of receiving rents or returns on its investments and distributing them to shareholders. In other words a company incorporated for the purpose of making profits for its shareholders amounts to the carrying on of a business when there is any gainful use to which it puts any of its assets. The ATO’s view stems from judicial precedents that the activities of a company unlike those of an individual are unlikely to be able to be described as the pursuit of a hobby or being undertaken to meet a domestic need. Where a company has no purpose or prospect of profit, it will be unlikely to be considered carrying on a business.

It is unclear in the case of corporate beneficiaries of a trust if it can be said that this can be considered conducting a carrying on of a business. The position of a corporate beneficiary who loans the unpaid present entitlement back to the trading trust be considered carrying on a business is unclear. If the controlling minds of the corporate beneficiary believe that the lending of the money back to the trust represents a gainful use to which it can apply its assets then this arguably satisfies the criteria for carrying on a business.

The proposed enterprise tax plan base rate bill, clearly intends that active business income that flows through a partnership or trust retains its income character when it is distributed to partners or beneficiaries. If the ATO takes the view that corporate beneficiaries who only receive trust distributions of active income are not considered carrying on a business then the proposed changes will not achieve the intended outcome. The Board of Tax Post Implementation Review of Division 7A recommended that there should be no impediments to the reinvestment of business income as working capital in active business activities.

The Enterprise tax plan base rate Bill needs to consider the ramifications from a policy perspective when an active business is being conducted in a trust and the trading profits it generates are loan backed as working capital into the business. This is particularly important if the ATO issues guidance that treats corporate beneficiaries only in receipt of trust distributions that loan the money back to an active business are not considered carrying on a business. The Bill allows eligibility to the lower corporate tax rate when active income flows indirectly via a trust and partnership through to a corporate entity but only if the company is carrying on a business. Active trading trusts that rely on funding from corporate beneficiaries will therefore be disadvantaged if such bucket companies are not considered carrying on a business. If the Government wants to ensure that the benefits of the lower corporate tax rate extends to such entities, then it should legislate accordingly to put the matter beyond doubt.

Another issue is where assets in the active business are held in another affiliated entity. Say for example, the property that is used by an active trading trust is beneficially owned by another trust. If the trust that owns the property charges rent for the use of the asset it will be considered passive income and therefore the subsequent distribution of this income to a corporate beneficiary will be labelled as passive. Is this the intent of the Bill to treat assets used in an active business which are owned by an affiliated entity any differently to the scenario of where the assets where directly owned by the active business? Clarification of this intention would be welcomed.

We thank you for the opportunity to provide a response to Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017**.**

If you wish to discuss any of our comments or would like further information then please don’t hesitate to contact Tony Greco at [tony.greco@publicaccountants.org.au](mailto:tony.greco@publicaccountants.org.au) or on mobile 0419 360038. We would be pleased to comment on any other matters on request.

Yours sincerely

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