Hi Simon

In para 1.10 of the EM, produced below, it states that dividends received by the parent company from the subsidiary will not be base rate entity passive income and also makes reference to the fact the subsidiary is carrying on business. However, the fact the dividend is a non-portfolio dividend is sufficient in itself (without the need for the subsidiary to carry on buisness for the dividend not to be base rate entity passive income. The example is, therefore, misleading. If the intention is for the dividend to be only capable of being non-passive where the payer company is carrying on business, the proposed amendments do not achieve this.

1.10 In addition, a non-portfolio dividend (within the meaning of section 317 of the ITAA 1936) is not base rate entity passive income. A non-portfolio dividend is, broadly, a dividend paid to a company where that company has a voting interest amounting to at least 10 per cent of the voting power in the company paying that dividend. Consequently, dividends derived, for example, by a holding company which are made by a wholly-owned subsidiary company **that carries on active trading business will** not be base rate entity passive income of the holding company.

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Hi Simon

Was hoping you may be able to help me with a couple of queries/issues

1. Proposed paragraph 23AB(e) states 'capital gains' are base rate entity passive income.

(a) Does this include disregarded capital gains?

- for example, a company sells a car for a capital gain which is disregarded under S.118-5(a) or S.118-24(1).
- if the capital gain is included as passive income the calculation becomes distorted.
- assume assessable income is $10,000 and disregarded capital gain is $2,200.
- the capital gain is 22% of assessable income (i.e., $2,200 / $10,000) therefore the company is not a base rate entity.
- if the capital gain was not disregarded the assessable income is now $12,200 and the capital gain is 18% (I.e., $2,200 / $12,200) of assessable and the company is a base rate entity

(b) If the answer to (a) is yes, what happens if a disregarded capital gain would also be reduced under S.118-20?

- for example, a company sells trading stock and each capital gain it makes is disregarded under S.118-25.
- if the disregarded capital gain is passive income, is the amount reduced to zero because of S.118-20?
- if the answer is no, then trading income is effectively being treated as passive income which is, no doubt, the intention on the amendments.

(c) What if the capital gain is eligible for a concession?

- a company makes a $100,000 capital gain which is reduced to $50,000 at step 4 of the method statement in S.102-5 (the 50% active asset reduction applies)
- if the whole $100,000 is passive income, the same distortion described at (a) above arises as only $50,000 of the capital gain form part of assessable income but the numerator includes the full $100,000

2. Proposed paragraph 23AB(a) says a dividend from another company is not passive if the dividend is a non-portfolio dividend.

If Company A's only assessable income is from a rental property, it will be taxed at the 30% rate (as it is not a base rate entity).

If Company A pays a dividend to Company B (who holds 20% of the ordinary shares), it is a non-portfolio dividend and not passive income – as such, Company B pays tax at 27.5% (subject to it not having other passive income) - it is entitled to a 30% franking asset so no tax is payable (and the excess is not refundable) - the credit in company B's franking account (from the franked dividend received from company A) is at the 30% rate but if it pays a dividend to an individual shareholder it franks the dividend at 27.5% rate.

It works this way because 30% tax has been paid by company A because its income was passive

I have explained to others that this is how the provisions work but have been met with resistance

It would be helpful if you could confirm or otherwise if this is how the proposed provisions are intended to work.

3. Proposed paragraph 23AB(e) says a distribution received by a company beneficiary will be taxed at 27.5% if no part of the distribution included in the company's assessable income is attributable to passive income.

If trust carries on a business and makes the company presently entitled to share of trust income, the company will be taxed at 27.5% as it is a base rate entity. That is, it has no base rate entity passive income. Of course, for this to be the case, it still needs to be carrying on a business which will likely be the case given the ATO has flagged it will interpret this requirement very broadly.

It would be helpful if you could confirm or otherwise the income of the company is not base rate entity passive income.

Cheers
Nick

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Hi Simon

At line 7 on page 3 - I suspect the word 'entity' should be inserted after 'passive' as lines 18 and 19 on page 4 refer to 'base rate entity passive income'

Also, it is proposed that for a company to access the 27.5% rate in 2017 it must be a base rate entity (BRE) and not a small business entity (SBE)
If a company had a turnover of $9 million in 2016, it automatically qualified as an SBE for 2017. If its aggregated turnover in 2017 was actually $10.2 million it still qualified as an SBE for 2017 on the basis of its 2016 aggregated turnover being less than $10 million (refer S.328-110). With the amendments, as proposed, this will no longer be the case. As the company's actual aggregated turnover for 2017 is at least $10m it is not a BRE and not eligible for the 27.5% rate.

I would query if this outcome is intended given the proposed amendments are targeted at companies deriving passive income. Obviously this will only effect companies whose turnover is below $10 million in 2016 but at least $10 million in 2017 but it seems unfair. Especially given these companies waited under 19 May 2017 to find out that they would qualify for the 27.5% rate and now they are looking at the possibility of reverting back to 30%.

A possible solution is a provision that provides that a company whose aggregated turnover in 2016 was less than $10m and who passed the 80% test is deemed to be a base rate entity in 2017.

Cheers
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