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Simon Winckler
Manager
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: simon.winckler@treasury.gov.au

Dear Simon

RE: Eligibility for the lower company tax rate

Thank you for the opportunity to provide comments on the exposure draft legislation for the proposed measures relating to the eligibility rules for the lower corporate tax rate.

By way of background, the Hayes Knight group of accounting firms provide a significant amount of taxation assistance and advice to corporate taxpayers across Australia. We also provide assistance to a large number of other accounting firms around Australia through the support and training services operated by Knowledge Shop.

We wish to make the following comments with respect to the exposure draft legislation.

1. While we welcome changes that seek to reduce some of the uncertainty that currently surrounds eligibility for the lower corporate tax rate, we do have concerns about the retrospective nature of these changes to some companies and their shareholders for the 2017 income year.

While it seems unlikely that any companies would end up with a lower 2017 corporate tax rate as a result of these changes, some companies will end up with a higher rate of 30% compared with the rate that would have applied in the absence of these changes.

This is partly due to the introduction of a new 80% passive income threshold but also due to the fact that the concept of "base rate entity" is being brought forward to the 2017 income year. At a very high level, this means that companies that would have qualified for the lower corporate tax rate in the 2017 year because of their 2016 income year turnover level (ie, less than $10m) would appear to be subject to a higher corporate tax rate of 30% in the 2017 year under the proposed changes if their actual turnover in the 2017 year is $10m or more, regardless of the respective level of passive / active business income for the year.

This could have flow-on implications from a cash flow perspective, the amount and franking rate of dividends that have been paid as well as the tax position of shareholders and beneficiaries where the shares are held through trusts. It also raises the issue of interest charges for companies and other taxpayers affected by the change who may have already lodged their 2017 tax returns.

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Some of these companies, shareholders and beneficiaries would already have lodged their 2017 tax returns. These would presumably need to be amended to reflect the updated rules. In addition, some of these companies have already been forced to amend franking percentage and notify shareholders as a result of the slow passage of the original legislation through Parliament. This will need to be revisited and further changes will need to be made in some instances.

For many companies and their advisers, backdating the changes to the 2017 income year will mean significant additional compliance costs in terms of checking whether the changes will impact on the corporate tax rate and franking rate and then making any necessary amendments.

2. The definition of base rate entity passive income includes dividends, but excludes non-portfolio dividends. This seems to indicate that dividends paid from passive profits derived by Company 1 can basically be refreshed as active business income in the hands of Company 2 if Company 2 holds shares in Company 1 which provide at least 10% of the voting power. This seems inconsistent with the way the provisions operate when income has been received from a partnership or trust.

This could also have flow-on implications in terms of franking credits. If we assume that Company 1 derives all its income from rental activities it will presumably pay tax at 30%. Dividends paid to Company 2 are treated as active income if it holds 10% or more of the voting power in Company 1. While Company 1 can frank dividends at 30%, if Company 2 qualifies for the lower corporate tax rate then it is likely to be restricted to paying out dividends to its shareholders at a 27.5% rate in many instances, potentially leaving some of the credits trapped in the company rather than passing through to the shareholders (excess franking credits received by Company 2 would presumably be converted to a tax loss).

3. While introducing a bright line income test is expected to reduce some of the current uncertainty surrounding eligibility for the lower corporate tax rate, the issue still remains as to whether a company is carrying on a business under general principles in the relevant income year. This issue is causing considerable uncertainty at the moment and will continue to do so despite these proposed changes.

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Thank you for your consideration of this submission. Should you have any queries then please do not hesitate to contact me on 02 9221 6666 or at Michael.Carruthers@hayesknight.com.au.

Yours faithfully

Michael Carruthers
Tax Director – Knowledge Shop Pty Ltd
On behalf of the Hayes Knight Group