# *Proposed changes to eligibility criteria for company tax rates*

*20 September 2017*

## *In brief*

On 18 September 2017, Treasury released exposure draft law on the Government's proposed changes to the eligibility criteria for the tax rate cut for smaller corporate tax entities.

These amendments are no doubt partly in response to the recent discussions in the media generating confusion around which entities qualify for the reduced tax rate. In brief, the measures are intended to clarify that predominantly passive investment companies cannot access the currently enacted lower company tax rate. This is achieved by adding additional criteria which must be satisfied before the lower rate can apply.

With a proposed retrospective start date, some taxpayers may already be disadvantaged by these proposed changes.

## *In detail*

The exposure draft law proposes amendments to ensure a corporate tax entity will not qualify for the lower corporate tax rate if 80 per cent or more of its assessable income is of a specifically defined 'passive' nature.

In addition, a proposed retrospective change affecting eligibility for the 27.5 per cent rate for the 2016-17 income year will replace the currently enacted requirement to be a 'small business entity', with the 'base rate entity' concept originally enacted to apply only from the 2017-18 income year. Not only does this change mean the new limitation on the extent of the company's passive income is relevant to determine eligibility for the 27.5 per cent rate for the 2016-17 year, but also when determining whether the entity's aggregated turnover falls below the $10 million threshold.  Specifically, when working out whether a company is a base rate entity, it is only the aggregated turnover for the actual income year that is relevant, unlike the 'small business entity' definition, which enables the aggregated turnover to be considered by reference to the prior year or the anticipated or actual aggregated turnover of the current year.

If the exposure draft law is enacted in its current form, a corporate tax entity will only qualify for the lower corporate tax rate if:

- it carries on a business in the income year; and
- the actual aggregated turnover of the corporate tax entity for the income year is less than:
    - $10 million, for the 2016-17 income year
    - $25 million, for the 2017-18 income year

    - $50 million for the 2018-19 income year and later, and
- it does not have 'base rate entity passive income' for the income year of 80 per cent or more of its assessable income for that year.

The new concept of 'base rate entity passive income' will be introduced into the law to include, among other things, dividends (excluding non-portfolio dividends which are broadly those dividends paid by a company in which the recipient has a voting interest of at least 10 per cent), capital gains, rent, interest, royalties, and certain amounts that flow through a partnership or a trust (to the extent that it is attributable to an amount of passive income).

Consequential amendments are also proposed to ensure that, when working out a company's corporate tax rate for dividend imputation purposes from the 2016-17 and later income years, regard is given to the company's base rate entity passive income and assessable income for the prior year, in addition to the company's aggregated turnover for that prior year.

The Government remains committed to introduce a lower corporate tax rate for all companies by the 2023-24 income year, with a separate Bill to enact the remainder of the Government's Enterprise Tax Plan currently before Parliament. If the plan is enacted, eventually there will be no limitation on the extent of any company's passive investment activity, as all companies will be subject to the lower rate from the 2023-24 income year.

## *The takeaway*

The latest proposals make it even more imperative for any company seeking to apply the lower tax rate to carefully consider the circumstances in which it operates, and the nature of its assessable income.

Although these proposed changes are intended to clarify the Government's position with respect to passive entities, the question of whether a company is 'carrying on a business' still remains a matter of considerable conjecture. Although the Australian Taxation Office (ATO) has indicated it is currently consulting on this issue, we are yet to see any additional guidance (see our TaxTalk Alert: Confusion over eligibility for company tax rate reduction of 13 July 2017).

The changes are also likely to bring added compliance complexity for some taxpayers that will now be required to monitor their 'base rate entity passive income' each year, in addition to their 'aggregated turnover'. This may make it difficult for a company to correctly frank a dividend that is paid during an income year.

If this proposed law is enacted in its current state, some taxpayers will need to revisit whether they are still eligible for the lower corporate tax rate.  Given the retrospective nature of the amendments, some taxpayers who previously were eligible for the 27.5 per cent tax rate for the 2016-17 year may now find they are no longer eligible. Similarly, some entities that have paid franked dividends at the 27.5 per cent rate this year or last year may need to revise this position. We expect the ATO to issue clarification on how they will administratively deal with companies that have applied the incorrect tax rate.

A short consultation period on the exposure draft law is now underway. Comments are due by 29 September 2017.

## *Let's talk*

For a deeper discussion of how these issues might affect your business, please contact:

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