

PCG 2018/D5 (Finalised) - Enterprise Tax Plan: small business company tax rate change: compliance and administrative approaches for the 2015-16, 2016-17 and 2017-18 income years

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! There is a Compendium for this document: **PCG 2018/8EC** .
This document has been finalised by PCG 2018/8.



Enterprise Tax Plan: small business company tax rate change: compliance and administrative approaches for the 2015–16, 2016–17 and 2017–18 income years

Relying on this draft Guideline

This Practical Compliance Guideline is a draft for consultation purposes only. When the final Guideline issues, it will have the following preamble:

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this draft Guideline is about

1. This draft Guideline sets out the ATO's compliance and administrative approaches for corporate tax entities that have faced practical difficulties in determining their corporate tax rate and corporate tax rate for imputation purposes in the 2015–16, 2016–17 and 2017–18 income years.
2. The Commissioner acknowledges that uncertainty may have arisen as a result of changes to the tax laws, and changes to these laws still before Parliament, that set out eligibility for the reduced corporate tax rate and the subsequent release of Draft Taxation Ruling TR 2017/D7 *Income tax: when does a company carry on a business within the meaning of section 23AA of the Income Tax Rates Act 1986?*.

Background

3. *Tax Laws Amendment (Small Business Measures No. 1) Act 2015* amended the *Income Tax Rates Act 1986* (ITRA 1986) to reduce the corporate tax rate to 28.5% for the 2015–16 income year for small business entities that were carrying on a business and had an aggregated turnover of less than \$2 million.

4. *Treasury Laws Amendment (Enterprise Tax Plan) Act 2017* amended the ITRA 1986 to reduce the corporate tax rate to 27.5% for the 2016–17 income year for small business entities that were carrying on a business and had an aggregated turnover of less than \$10 million.

5. To assist corporate tax entities interpret the phrase ‘carrying on a business’ to determine eligibility for the reduced corporate tax rate, the ATO released TR 2017/D7 on 18 October 2017.

6. On 18 October 2017, the Government introduced the *Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017* (the Bill). The Bill has not yet passed the Senate. When enacted, it will remove the ‘carrying on a business’ requirement. Under the proposed changes, a corporate tax entity will be eligible for the reduced rate from the 2017–18 income year, if:

- (a) no more than 80% of its assessable income is base rate entity passive income, and
- (b) its aggregated turnover is less than \$25 million.¹

7. Until the Bill is passed, a corporate tax entity must meet the criteria under the existing law (*Treasury Laws Amendment (Enterprise Tax Plan) Act 2017*) in order to be eligible for the reduced corporate tax rate in the 2017–18 income year. These are that it:

- (a) carries on a business and
- (b) has an aggregated turnover of less than \$25 million.

8. Given the timing of the passage of these Acts, the unenacted amendments in the Bill and the timing of the release of TR 2017/D7, some corporate tax entities may have made decisions about their eligibility for the reduced corporate tax rate without knowledge of or in anticipation of the subsequent operation of the law and the ATO’s view of what constitutes ‘carrying on a business’. This may have led to some corporate tax entities lodging tax returns for the 2015–16 and 2016–17 years without certainty of the correct position. It may also have led to some corporate tax entities issuing distribution statements to members based on a franking rate that is incorrect.

9. In light of this uncertainty, the Commissioner will apply two approaches to assist affected corporate tax entities.

- (a) A facilitative compliance approach will apply to the ‘carrying on a business’ test for corporate tax rate purposes in transition to the new eligibility rules for the lower rate.
- (b) A practical administrative approach will apply that allows corporate tax entities to choose a simplified method to inform members of the correct franking credit to which they are entitled.

Date of effect

10. This draft Guideline has effect from the first day of a corporate tax entity’s 2015–16, 2016–17 or 2017–18 income year, depending on the entity’s circumstances as outlined in paragraphs 11 to 22 of this draft Guideline.

¹ A draft Law Companion Ruling entitled *Base rate entities and base rate entity passive income*, which will be released when the Bill is enacted, will provide more information.

Compliance approach: determination of tax rate

11. Under self-assessment, the Commissioner expects taxpayers to fulfil their obligations under the tax laws and assumes that the information provided by taxpayers in their tax returns is complete and accurate. As is always the case, the Commissioner may undertake review activity to ensure compliance, particularly where there is reason to believe a taxpayer's self-assessment, or the information provided, is incorrect.

12. Given the uncertainty around the 'carrying on a business' test prior to the release of TR 2017/D7, the Commissioner will adopt a facilitative approach to compliance in relation to the application of the carrying on a business test. This means that the Commissioner will not allocate compliance resources specifically to conduct reviews of whether corporate tax entities have applied the correct rate of tax or franked at the correct rate in the 2015–16 and 2016–17 income years. However, this approach will not apply where:

- (a) the Commissioner becomes aware that a corporate tax entity's assessment of whether they were carrying on a business in the 2015–16 or 2016–17 income years was plainly unreasonable, or
- (b) the corporate tax entity has entered into
 - (i) any artificial or contrived arrangement affecting the characterisation of the company as carrying on a business or not
 - (ii) a tax avoidance scheme whose outcome depends, in whole or part, on the characterisation of the company as carrying on a business or not, or
 - (iii) arrangements designed to conceal ultimate beneficial or economic ownership of any connected or affiliated entities.

13. In addition, the approach will not apply where a corporate tax entity has attracted ATO compliance activity for reasons unrelated to whether the correct corporate tax rate has been applied by the corporate tax entity.

Administrative approach: incorrect franking

Written notification informing members

14. The maximum franking credit entitlement for a member in receipt of a franked distribution is determined by applying the formula in section 202-60 of the *Income Tax Assessment Act 1997* (ITAA 1997). Under this section, the corporate tax rate for imputation purposes is used to calculate the maximum franking credit for a distribution.

15. An entity that makes a frankable distribution must give the recipient a distribution statement that includes the amount of the franking credit on the distribution.² Ordinarily, where a corporate tax entity has issued an incorrect distribution statement, it would need to apply to the Commissioner for permission to amend and reissue the distribution statement.³

16. A corporate tax entity may have issued an incorrect distribution statement for a frankable distribution in the, 2016–17 or 2017–18 income years due to:

- (a) the proposed amendments in the Bill, or

² Subsection 202-75(1) of the ITAA 1997.

³ Section 202-85 of the ITAA 1997.

- (b) the passage of the amending Acts⁴ subsequent to the distribution being made (see paragraphs 3 to 7 of this draft Guideline) and the release of TR 2017/D7.

17. In these circumstances the corporate tax entity may inform its members of the correct franking credit to which they are entitled under the revised corporate tax rate in writing without reissuing the distribution statement.

18. This administrative approach applies in relation to affected frankable distributions made by corporate tax entities in the 2016–17 and 2017–18 income years.

19. The Commissioner will not impose penalties on the corporate tax entity for giving a member an incorrect distribution statement provided it gives written notice to each of its members clearly showing the correct amount of the franking credit. The notice should be provided in the same way as the distribution statement was provided (which may be electronically by email).

20. The corporate tax entity can provide this notice to their members without seeking an exercise of the Commissioner's discretion to allow amendment of the distribution statement.

21. The notice should indicate that the distribution statement previously provided was incorrect and should contain the following details, such that the recipient has enough information to meet their tax obligations for the distribution:

- (a) name of the entity making the distribution
- (b) date on which the distribution was made
- (c) amount of the distribution
- (d) revised amount of franking credit allocated to the distribution, rounded to the nearest cent
- (e) franking percentage for the distribution, worked out to two decimal places
- (f) amount of any withholding tax deducted from the distribution, and
- (g) name of the member.

22. The corporate tax entity must adjust its franking account to reflect the fact that the franking debit to the account should be calculated by reference to the correct corporate tax rate.

Amended distribution statement

23. Alternatively, the corporate tax entity may apply to the Commissioner for permission to amend the distribution statement under section 202-85 of the ITAA 1997.

24. If the Commissioner grants permission, the corporate tax entity would then be able to provide the member with a new distribution statement and no penalty would be imposed for the initial incorrect statement.

Example 1

25. *ABC Co pays a fully franked distribution to a member of \$100. The distribution was made on 31 December 2016 before the Treasury Laws Amendment (Enterprise Tax Plan) Act 2017 became law. Applying the 30% tax rate that applied at that time to ABC Co, the company calculated the franking credit to be allocated to the distribution to be:*

⁴ Tax Laws Amendment (Small Business Measures No. 1) Act 2015 and the Treasury Laws Amendment (Enterprise Tax Plan) Act 2017.

$$\$100 \times 0.30 / (1 - 0.30) = \$42.86.$$

26. *ABC Co provides a distribution statement to the member that states that the franking credit on the distribution is \$42.86.*

27. *Subsequently the Treasury Laws Amendment (Enterprise Tax Plan) Act 2017 was passed which reduced the corporate tax rate for small businesses with an aggregated turnover of less than \$10 million to 27.5% for their 2016–17 income year. ABC Co meets the criteria for the lower corporate tax rate and maximum franking credit for distributions in the 2016–17 income year becomes based on this lower 27.5% corporate tax rate. The result is the initial franking credits allocated to the distribution exceed the maximum franking credit for the distribution and the distribution statement is incorrect.*

28. *Instead of seeking an exercise of the Commissioner's discretion to allow an amended distribution statement, ABC Co sends a letter to each of its members containing the details set out in paragraph 21 of this draft Guideline, and explaining that the original distribution statement was incorrect.*

29. *When members lodge or amend their tax return, they will be able to use the information in this letter to determine the maximum franking credit on the distribution based on the 27.5% tax rate. Using section 202-65 of the ITAA 1997, this would be calculated as*

$$\$100 \times 0.275 / (1 - 0.275) = \$37.93.$$

30. *No penalty is imposed by the ATO.*

Commissioner of Taxation

25 July 2018

Your comments

31. You are invited to comment on this draft Guideline including the proposed date of effect. Please forward your comments to the contact officer by the due.

32. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: 24 August 2018

Contact officer details have been removed following publication of the final guideline.

References

ATOlaw topic(s)	Income tax ~~ Assessable income ~~ Business and professional income ~~ Carrying on a business Income tax ~~ Capital management ~~ Frankability of distribution Income tax ~~ Capital management ~~ Franking credits / tax offsets
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Legislative references	ITAA 1997 ITAA 1997 202-60 ITAA 1997 202-65 ITAA 1997 202-75(1) ITAA 1997 202-85 ITRA 1986 Tax Laws Amendment (Small Business Measures No. 1) Act 2015 Treasury Laws Amendment (Enterprise Tax Plan) Act 2017
Related Rulings/Determinations	TR 2017/D7
Other references	Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017
ATO references	1-E9WYZBY
BSL	IND

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