1998-99

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

NEW BUSINESS TAX SYSTEM (MISCELLANEOUS) BILL 1999

NEW BUSINESS TAX SYSTEM (VENTURE CAPITAL DEFICIT TAX) BILL 1999

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Peter Costello, MP)

28231 Cat. No. 99 2087 9 ISBN 0642 426678

Table of contents

Glossary

The following abbreviations and acronyms are used throughout this Explanatory Memorandum.

Abbreviation	*Definition*
ADF	approved deposit fund
A Platform for Consultation	*Review of Business Taxation: A Platform for Consultation*
A Tax System Redesigned	*Review of Business Taxation: A Tax System Redesigned*
ANTS	Government's Tax Reform Document: *Tax Reform: not a new tax, a new tax system*
Capital Allowances Bill	New Business Tax System (Capital Allowances) Bill 1999
Capital Gains Tax Bill	New Business Tax System (Capital Gains Tax) Bill 1999
CGT	capital gains tax
Commissioner	Commissioner of Taxation
CS/RA	complying superannuation/roll-over annuity
FAT	franking additional tax
HECS	Higher Education Contribution Scheme
Income Tax Rates Bill No. 1	New Business Tax System (Income Tax Rates) Bill (No. 1) 1999
Integrity and Other Measures Bill	New Business Tax System (Integrity and Other Measures) Bill 1999
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
PAYE	Pay as you earn
PDF	pooled development fund
section 46 rebate	rebate available under section 46 and 46A of the ITAA 1936
SME	small and medium business enterprises
the Recommendations	*Review of Business Taxation: A Tax System Redesigned*
the Review	Review of Business Taxation

General outline and financial impact

Intercorporate dividend rebate

This Bill amends the ITAA 1936 to:

- remove the inter-corporate dividend rebate on unfranked dividends paid between resident companies on or after 1 July 2000 (unless they are part of a wholly owned company group); and
- allow certain non-resident owned companies a tax deduction to offset the removal of the rebate to ensure that commercially viable investment in Australia is not impeded.

Date of effect: The amendments apply to dividends paid on or after 1 July 2000.

Proposal announced: The proposal was announced in Treasurer's Press Release No. 58 of 21 September 1999 (see Attachment L).

Financial impact: The financial impact of this measure is set out in the table below:

2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
$35m	–$70m	–$120m	–$155m	–$125m

Compliance cost impact: By removing the intercorporate dividend rebate on unfranked dividends compliance costs will decrease for companies eligible for the rebate now because they will no longer have to calculate the rebate. There will also be a reduction in compliance costs for companies that currently have to decide if they are a private or public company, to know if they are eligible for the rebate. This can be difficult, as their status for tax law purposes is not necessarily the same as it is for company law.

Refunding excess imputation credits

This Bill amends the ITAA 1997 to enable taxpayers whose tax rates are below the company tax rate, to receive a refund of excess imputation credits (franking rebates) obtained from franked dividends.

Date of effect: The amendments apply to dividends paid on or after 1 July 2000.

Proposal announced: The proposal was announced in Treasurer's Press Release No. 58 of 21 September 1999 (see Attachment M).

Financial impact: Implementing this measure will have a revenue cost. The revenue impact was identified as part of the business tax measures outlined in ANTS.

Compliance cost impact: Taxpayers who currently do not lodge a tax return will need to in order to claim their imputation credit refund.

Company rate changes (franking account and infrastructure borrowings rebate consequentials)

This Bill amends the ITAA 1936 to make consequential amendments to the dividend imputation and the infrastructure borrowings rebate provisions of the Act following the reduction in the company tax rate.

Date of effect: The amendments to the dividend imputation provisions apply from 1 July 2000. The amendments reflecting the new 34% company tax rate in the infrastructure borrowings rebate provisions apply to assessments for the 2000-2001 income year. The amendments reflecting the new 30% company tax rate in the infrastructure borrowings rebate provisions apply to assessments for the 2001-2002 and later income years.

Proposal announced: The proposal was announced in Treasurer's Press Release No. 58 of 21 September 1999 (see Attachment A).

Financial impact: The financial impact of this measure has been factored into the revenue estimates for the reduction in the company tax rate made by the Income Tax Rates Bill No. 1.

Compliance cost impact: Companies may incur a small one off cost in converting their franking account balances.

Venture capital franking rebates

This Bill amends the ITAA 1936 to encourage venture capital investment in Australia by allowing complying superannuation funds and like entities a special franking rebate which enables them to receive venture capital gains, free of tax through a PDF. (A separate Bill, the New Business Tax System (Venture Capital Deficit Tax) Bill 1999, complements this measure.)

Date of effect: The amendments apply to venture capital gains PDF derived after the Capital Gains Tax Bill receives Royal Assent.

Proposal announced: The proposal was announced in Treasurer's Press Release No. 58 of 21 September 1999 (see Attachment H).

Financial impact: The financial impact of this measure is included in the cost to the revenue of the measures to improve incentives for venture capital investment announced by the Treasurer on 21 September 1999 (including those relating to non-resident pension funds). The measure will have no impact to the revenue until the 2004-2005 financial year when there will be a revenue loss of $5 million.

Compliance cost impact: The proposal may result in a small increase in compliance costs for PDFs that opt to provide the benefit of the special franking rebate to its eligible shareholders.

Low-value pools

This Bill amends the ITAA 1936 to:

- replace, for certain taxpayers, immediate deductibility for plant costing $300 or less with a right to pool plant costing less than $1,000 and to depreciate that pool, as a single item of plant, over an effective life of 4 years; and
- allow certain taxpayers to add plant to that pool if it was written down to less than $1,000 under the diminishing value method.

Date of effect: The amendments regarding the removal of the immediate deduction and the option to pool plant costing less than $1,000 will commence in the income year in which 1 July 2000 occurs. The amendments regarding the option to pool plant that has been depreciated to less than $1,000 will commence from the 2000-2001 income year.

Proposal announced: The proposal was announced in Treasurer's Press Release No. 58 of 21 September 1999 (see Attachment B).

Financial impact: The financial impact of this measure is set out in the table below.

2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
$30m	$410m	$40m	–$80m	–$180m

Compliance cost impact: The proposal will significantly reduce compliance costs for those taxpayers who opt to use the pooling system.

Summary of regulation impact statement

Regulation impact on business

Impact: The measures contained in these Bills are part of the Government's broad-ranging reforms that will give Australia a New *Business* Tax System. These reforms are based on the Recommendations of the Review that the Government established to consider reforms to Australia's business tax system.

The New *Business* Tax System will be a more simple and sound tax system with lower compliance costs.

Main points:

- Potential compliance, administrative and economic impacts of the measures contained in these Bills have been carefully considered, both by the Review and the business sector. Substantial consultation with the business sector was an important part of the Review.
- Most of the measures in these Bills affect a particular group of taxpayers (e.g. the measures dealing with the intercorporate dividend rebate will affect companies).
- Some of the measures have wider effects (e.g. changes to imputation to reflect the decreased company rate of tax).
- The refundability of excess imputation credits from 1 July 2000 will have some impact on administration costs. This is because additional tax returns are expected to be lodged, so that refunds can be claimed. The other measures in this Bill are not expected to impose significant ongoing administration costs.

Chapter 1
Intercorporate dividend rebate

Outline of Chapter

1.1 This Chapter explains changes to the taxation of dividends that are paid by one company to another. There are 2 elements to the changes:

- where the dividend is unfranked, no section 46 rebate will be allowed unless the dividend is paid within a wholly owned company group;
- where a resident company receives an unfranked non-portfolio dividend and on-pays it to its non-resident parent, the denial of the section 46 rebate will effectively be negated by allowing a deduction for the on-payment.

1.2 The first change affects only certain dividends. The law does not change for private companies, dual residents, dividends paid by certain exempting companies, or dividends subject to certain determinations made by the Commissioner.

1.3 The second change affects only resident companies that receive and on-pay certain unfranked dividends to a non-resident parent.

1.4 The changes apply to dividends paid on or after 1 July 2000. They are in Schedule 1 to this Bill and alter section 46F of the ITAA 1936.

Context of Reform

What is the current treatment of intercorporate dividends?

1.5 Sections 46 and 46A of the ITAA 1936 provide that resident company shareholders are generally entitled to a rebate for dividends received from other resident companies.

1.6 However, this is limited by certain provisions. For example, among other things, section 46F denies the rebate to private companies that receive unfranked dividends, and for unfranked dividends paid or received by dual residents.

Why is the current law being changed?

Usually there will be no section 46 rebate for unfranked dividends

1.7 The current law treats different resident companies in an inconsistent manner. It has resulted in loopholes because most unfranked dividends between companies are freed from tax. This has led to a wide range of complex anti-avoidance provisions dealing with the availability of the section 46 rebate.

1.8 The Review considered the advantages of the current treatment to be unwarranted where the distribution is not between companies within a wholly owned group. Therefore, it recommended that the law be altered.

Resident companies on-paying unfranked dividends to non-resident parent companies

1.9 The proposed changes to unfranked dividends may impede investment in Australia by non-residents by treating different forms of investment differently.

1.10 Non-residents who invest in Australia by setting up an Australian resident subsidiary may be adversely affected by these changes. However, non-residents who invest directly in an incorporated joint venture, or through an Australian partnership or trust will not be affected by this measure. This is because, in these cases, a distribution to the non-resident will usually be subject to dividend withholding tax (generally at a 15% rate) rather than being taxed at the company tax rate. To ensure that this does not occur, the effect of removing the section 46 rebate will be offset by a deduction in certain circumstances.

1.11 The Review considered that the tax system should not discriminate against commercially viable projects depending on whether investment is made through an incorporated or unincorporated joint venture. Therefore, it recommended that all non-residents who invest in Australia be treated in the same manner.

Summary of new law

1.12 The new law will ensure consistent treatment of all resident companies that receive unfranked dividends. Section 46F will apply to deny a rebate on unfranked dividends that are received by all resident companies, unless the distribution is paid between resident companies within a wholly owned company group.

1.13 Broadly, the new law will also ensure consistent treatment of non-residents who invest in Australia. Sections 46FA and 46FB will operate to negate the denial of the section 46 rebate in certain cases by allowing a deduction for on-payments of unfranked non-portfolio dividends by a resident company to its non-resident parent.

1.14 The new law applies to dividends paid on or after 1 July 2000.

Comparison of key features of new law and current law

New Law	*Current Law*
No company will be entitled to a rebate for unfranked dividends unless the distribution is paid between companies within a wholly owned group.	Most unfranked dividends received by a resident company are entitled to a rebate under section 46 unless: • the company receiving the dividend is a private company (unless the dividend is paid within a wholly owned group); • the company receiving the dividend is a dual resident; • the company paying the dividend is a dual resident or an exempting company; or • the dividend is subject to certain determinations by the Commissioner.
The new law will operate to negate the denial of the section 46 rebate in certain cases above by allowing a deduction for on-payments of unfranked non-portfolio dividends by a resident company to its non-resident parent.	The current law is explained above. The new law is necessary to ensure that the current treatment effectively continues in these cases.

Detailed explanation of new law

Usually there will be no section 46 rebate for unfranked dividends

1.15 Most resident public companies that receive unfranked dividends will no longer be entitled to a rebate on those dividends ***[Schedule 1, item 1, subsection 46F(2)]***. However, this does not apply if the dividend is paid within a wholly owned company group. This ensures consistent treatment of unfranked dividends received by public and private resident companies.

Example 1.1

> Curtains Ltd and Blinds Ltd are resident public companies that are not members of a wholly owned company group. Curtains pays an unfranked dividend to Blinds. Blinds will not be entitled to a rebate under section 46 of the ITAA 1936 for this dividend.

1.16 The new law will also ensure that a company that receives an unfranked dividend through a trust or partnership will generally not be entitled to a section 46 rebate. This is because in most situations a company would not be entitled to a rebate if it had received the dividend directly (rather than indirectly through the trust or partnership). Because entitlement to the rebate for corporate beneficiaries and partners is determined through section 45Z, which adopts a *look-through* approach, a company is only entitled to a rebate if it would have been entitled to a rebate had it received the dividend directly, rather than indirectly through the trust or partnership.

1.17 The law does not change for dividends where the company receiving them is not currently entitled to a section 46 rebate. These dividends include unfranked dividends:

- paid to private companies (other than those within a wholly owned group);
- paid to dual resident companies;
- paid by dual resident companies or certain exempting companies; or
- subject to a determination by the Commissioner under paragraph 160AQCBA(3)(b) or 177EA(5)(b) that no franking credit benefit is available (because the dividend is paid under a dividend streaming or other avoidance arrangement).

Example 1.2

South and Daughter Ltd is a resident public company that receives dividends on 30 July 2000:

- an unfranked dividend is paid by The Chocolate Shoppe (the Chocolate Shoppe is a member of the same wholly owned company group as South and Daughter); and
- an unfranked dividend is paid by Clocks R Us (Clocks R Us is a resident company that is not part of a wholly owned company group).

The treatment of the dividends is set out below:

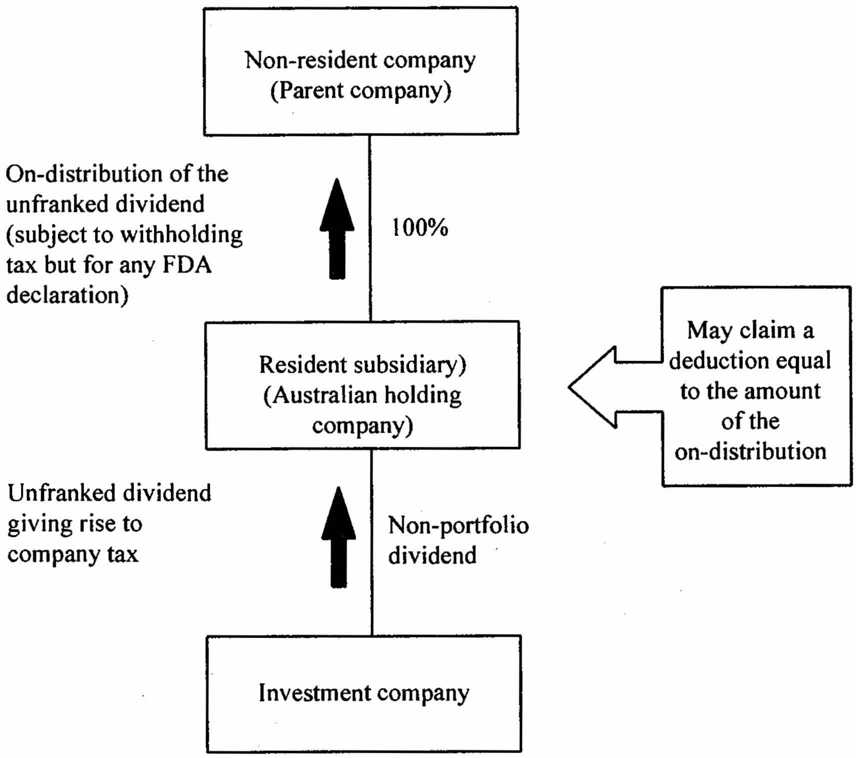
- The dividend paid by The Chocolate Shoppe is entitled to a section 46 rebate. This is because distributions paid between members of a wholly owned company group are not affected by this measure.
- The dividend paid by Clocks R Us is not entitled to the section 46 rebate. The dividend is subject to this measure.

Resident companies on-paying unfranked dividends to non-resident parent companies

1.18 The new law acts to ensure consistent treatment of non-residents who invest in Australia. Sections 46FA and 46FB will operate to negate the denial of the section 46 rebate in certain cases by allowing a deduction for on-payments of unfranked non-portfolio dividends by a resident company to its non-resident parent.

1.19 Diagram 1.1 shows the circumstances in which the new law operates, where the conditions for the new law are met.

Diagram 1.1



1.20 A ***non-portfolio dividend*** is defined in section 317 of the ITAA 1936 ***[Schedule 1, item 2, subsection 46FA(11) and item 2, subsection 46FB(6)].*** Broadly speaking, it is a dividend paid to a company with at least a 10% voting interest in the company paying the dividend.

1.21 The new law generally applies where:

- a resident company (Company A) pays a non-portfolio unfranked or partly franked dividend to another resident company (Company B) ***[paragraph 46FA(1)(a)]***;

- Company A and Company B are not members of the same wholly owned company group in the year in which the dividend is paid (where Company A and Company B are members of the same wholly owned company group, the section 46 rebate will generally apply – this is discussed at paragraphs 1.15 to 1.17) ***[paragraph 46FA(1)(b)]***;
- Company B on-pays that amount to its sole non-resident owner as an unfranked or partly franked dividend (the 'flow-on amount') ***[paragraphs 46FA(1)(d) and (e)]***;
- the flow-on amount does not exceed the amount in Company B's unfranked non-portfolio dividend account (the account cannot be in deficit – see paragraphs 1.29 to 1.36) ***[subsection 46FA(4)]***;
- the flow-on amount is not greater than the unfranked amount of the dividend on-paid ***[paragraph 46FA(1)(f)]***;
- Company B makes the relevant declaration in writing before paying the dividend. This is called the ***flow-on declaration*** and specifies the amount to be on-paid under these provisions ***[paragraphs 46FA(1)(f) and subsection 46FA(3)]***.

1.22 Company B must be a resident company, wholly owned by the same non-resident company at all relevant times. These times are when it receives the original dividend from Company A, when it makes the flow-on declaration, and when it pays the dividend to its non-resident parent. ***[Paragraph 46FA(1)(g)]***

1.23 Where the requirements of the new law are met, Company B may claim the on-payment as a tax deduction, effectively freeing the unfranked non-portfolio dividend from income tax ***[subsection 46FA(1)]***. The amount eligible to be claimed as a tax deduction is the percentage of the dividend specified in the flow-on declaration multiplied by the unfranked amount of the dividend ***[subsection 46FA(2)]***.

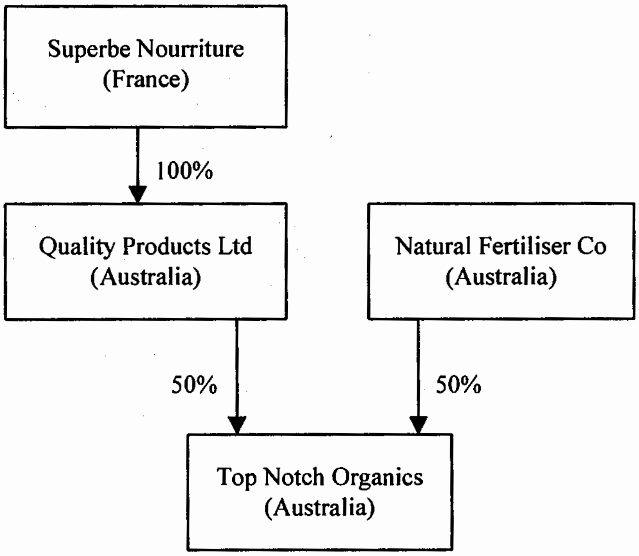
1.24 Provided that the distribution is made in the same income year that Company B derives the dividend, the dividend will be directly freed from tax. If the on-payment is made in a subsequent income year, the deduction is available to free other income from tax in that income year. ***[Subsection 46FA(1)]***

1.25 As the distribution to the non-resident is unfranked, it will usually be subject to dividend withholding tax.

1.26 The operation of the new law is shown in Example 1.3.

Example 1.3

The Natural Fertiliser Co and Quality Products Ltd are Australian resident companies. Quality Products is wholly owned by Superbe Nourriture, a French company. Natural Fertilisers and Quality Products are involved in a joint venture to produce high quality organic produce for the international market. They set up a company, Top Notch Organics, in which they each own 50% of the shares. The structure is shown by the following diagram.



Top Notch Organics pays an unfranked dividend of $100 to Quality Products on 15 November 2000. To take advantage of the new provisions, Quality Products:

- on-pays the dividend to Superbe Nourriture in the same financial year that it received the dividend;
- makes a declaration under paragraph 46FA(1)(f) in writing before on-paying the dividend;
- if applicable, deducts withholding tax of $15 from the $100 dividend before on-paying it (therefore, $85 is paid to Superbe Nourriture); and
- claims a deduction equal to the amount of the dividend ($100).

When is a company wholly owned by a non-resident?

1.27 A company (Company B) is ***wholly owned by a non-resident company*** if the non-resident company (Company C) directly owns all of the shares in Company B (both beneficially and legally) ***[subsection 46FA(6)]***. However, if a third party is in a position to affect rights as between Company B and Company C, presently or in the future, then Company B is not wholly owned by a non-resident company ***[subsections 46FA(7) and (8)]***.

1.28 The definition of 'wholly owned by a non-resident company' is based on the definition of '100% subsidiary' in section 975-505 of the ITAA 1997.

1.29 ***A person is in a position to affect rights*** of Company C in relation to Company B if, for any reason, they are able to acquire those rights, or to somehow prevent either Company B or Company C from exercising those rights as it chooses ***[subsections 46FA(9) and (10)]***. The definition is the same as the definition of 'in a position to affect rights' in section 975-150 of the ITAA 1997.

How does a company track the on-payment of a dividend?

1.30 A company may set up an unfranked non-portfolio dividend account ***[subsection 46FB(1)]***. However, to take advantage of the new law, a company must set up an unfranked non-portfolio dividend account ***[subsection 46FA(4)]***.

1.31 The account effectively records the unfranked non-portfolio dividends that are available for on-distribution to the non-resident parent company. An on-distribution is taken to be made if a declaration is made to that effect. The on-paid dividend is a ***flow-on dividend***. ***[Paragraphs 46FA(1)(d) and (f)]***

1.32 If the amount in the declaration is more than the surplus in the unfranked non-portfolio dividend account (the account) at the time the declaration is made, a deduction is only allowed for the amount that is actually in the account ***[subsection 46FA(4)]***. This is because the account cannot be in deficit. In other words, a company cannot on-distribute more unfranked non-portfolio dividends than it receives.

1.33 If the total unfranked non-portfolio dividend credits is greater than the total unfranked non-portfolio dividend debits at a particular time, then the account has a surplus. The amount of the surplus is the difference between the credits and debits. ***[Subsections 46FB(2) and (3)]***

1.34 A credit to an unfranked non-portfolio dividend account only arises if Company B receives an unfranked non-portfolio dividend from a resident company (Company A) on or after 1 July 2000. Company A and Company B cannot be part of the same wholly owned company group.

1.35 Also, Company B must be entitled to a rebate under section 46 for the unfranked part of the dividend if it were not for the fact the rebate is denied for unfranked dividends ***[subsection 46FB(4) and paragraph 46FA(1)(c)]***. The effect of this requirement is that no credit will arise if, for example, the dividend is paid under a dividend stripping or franking credit trading arrangement.

1.36 The amount of the credit is the unfranked amount of the dividend. It is credited to the account when it is paid to Company B. ***[Subsection 46FB(4)]***

1.37 Once the declaration has been made, the amount in the declaration is debited to the unfranked non-portfolio dividend account. ***[Subsection 46FB(5)]***

Example 1.4

> Using the information in Example 1.3, if Quality Products does not establish an unfranked non-portfolio dividend account, then it cannot claim an income tax deduction for the amount of the on-payment.
>
> If Quality Products establishes an unfranked non-portfolio dividend account, then the $100 dividend from Top Notch Organics may be credited to that account.
>
> If Top Notch also distributes a $50 franked dividend, this amount cannot be credited to the unfranked non-portfolio dividend account.
>
> The unfranked non-portfolio dividend account now has a surplus of $100. On 16 November 2000, Quality Products makes a flow-on declaration. Although it does not on-pay the $100 dividend until 30 May 2001, the account is debited by $100 on 16 November 2000. This is because the amount is debited to the account when the declaration is made.
>
> If Quality Products pays $150 to Superbe Nourriture and makes the declaration in relation to $150, then Quality Products is only entitled to an income tax deduction of $100. This is because the unfranked non-portfolio dividend account cannot be in deficit.

1.38 There will be circumstances where the on-payment has a class A or class C required franking amount (under section 160AQE). Because a flow-on declaration can only be made in relation to the unfranked part of a dividend, a company may expose itself to under-franking penalties under section 160APX if it fails to frank the dividend to take advantage of this measure. To prevent this, the flow-on amount of the on-payment is treated as though it were a class A or class C franked amount for the purposes of section 160APX. ***[Paragraphs 46FA(5)(a) and (b)***

1.39 If the dividend has both a class A and a class C required franking amount, then the treatment for the purposes of section 160APX is ordered.

- First, the flow-on amount is treated as though it is a class A franked amount.

- Then, if there is a remaining flow-on amount, it is treated as though it is a class C franked amount.

[Paragraph 46FA(5)(c)]

1.40 This treatment ensures that Company B does not suffer any penalty for under-franking the dividend ***[subsection 46FA(5)]***. This is illustrated by Example 1.5.

Example 1.5

Using the facts from Example 1.3, Quality Products declares a dividend of $200 to Superbe Nourriture, $100 of which is class C franked and $100 of which is unfranked and represents the dividend referred to in Example 1.3. The company has made a flow-on declaration that results in $100 of the dividend being a flow-on amount. The class C required franking amount for the dividend paid to Superbe Nourriture is $160. The on-payment is taken to be franked to $200 for the purposes of section 160APX. Therefore, no under-franking occurs for section 160APX purposes.

Example 1.6

Using the facts from Example 1.5, Quality Products is a life insurance company and pays the same dividend, but with the following required franking amounts:

- $140 class A required franking amount; and
- $20 class C required franking amount

and the actual franked amounts of the dividend are:

- $80 class A franked amount; and
- $20 class C franked amount

then, the on-payment is taken to be class A franked to $140 and then class C franked to $60 for the purposes of section 160APX. Therefore, no under-franking occurs for section 160APX purposes.

Application and transitional provisions

1.41 The denial of the section 46 rebate for unfranked dividends applies to dividends paid on or after 1 July 2000. ***[Schedule 1, item 4]***

1.42 The changes applying to non-resident owned companies apply in relation to unfranked non-portfolio dividends paid on or after 1 July 2000. That is, only those dividends can provide a credit to the unfranked non-portfolio dividend account and so be on-paid to the non-resident owner in a deductible form. For most companies, this will be the start of their 2000-2001 income year. ***[Item 4]***

Consequential amendments

1.43 Section 12-5 of the ITAA 1997 is a non-operative provision that contains a list of available tax deductions. Deductions that relate to unfranked non-portfolio dividends on-paid to a non-resident parent company under this measure are added to this list. ***[Schedule 1, item 3, section 12-5]***

Chapter 2
Refunding excess imputation credits

Outline of Chapter

2.1 This Chapter explains the changes to the treatment of excess imputation credits (franking rebates). Taxpayers who receive franking rebates will be entitled to a refund if their franking rebates exceed tax payable.

2.2 These changes apply to taxpayers who are entitled to franking rebates, except trustees liable to be assessed under section 99A of the ITAA 1936. The changes apply to imputation credits in relation to dividends paid by companies on or after 1 July 2000.

Context of Reform

What is the current treatment of excess imputation credits?

2.3 Current subsection 4-10(3A) of the ITAA 1997 provides that imputation credits that exceed a taxpayer's income tax liability are disregarded. That is, they cannot be refunded.

Why is the law being changed?

2.4 The current treatment means that low-income earners and certain other taxpayers may pay tax on dividend income at a rate higher than their marginal tax rate. This is because the company distributing the dividends may have already paid tax (at the company tax rate) on profits before distributing them as dividends.

2.5 The Review considered that resident individuals and superannuation funds and like entities should be taxed at their appropriate tax rates, rather than at the company tax rate. Therefore, it recommended that excess imputation credits be refunded to these taxpayers.

Summary of new law

2.6 The new law ensures that resident individuals and other taxpayers eligible for this measure will be taxed on dividends at their appropriate tax rates. Once imputation credits have been used to offset any income tax liability, any excess credits will be refunded to these taxpayers. This is the same as the current treatment for the private health insurance tax offset.

2.7 The new law applies to imputation credits relating to dividends paid on or after 1 July 2000. For most taxpayers, this means that it applies from the start of their 2000-2001 income year.

Comparison of key features of new law and current law

New Law	*Current Law*
Individuals and most other taxpayers who receive imputation credits and are entitled to franking rebates will be entitled to a refund of those credits after offsetting them against their income tax liability. In this manner, imputation credits are treated in the same way as the private health insurance tax offset.	All taxpayers are entitled to use their imputation credits to offset any income tax payable. Any excess imputation credits are disregarded.

Detailed explanation of new law

What are excess imputation credits?

2.8 Certain taxpayers, such as individuals and superannuation funds, who receive partly or fully franked dividends are entitled to a franking rebate for imputation credits attached to the dividends. The imputation credit is equal to the amount of company tax paid relating to the dividends. The franking rebate is a tax offset that is available to reduce the taxpayer's income tax liability. The term *imputation credits* is used in this Chapter to refer to *franking rebate*.

2.9 A taxpayer has excess imputation credits if their total imputation credits from dividends paid on or after 1 July 2000 are greater than their income tax liability, once they have used any other tax offsets to which they are entitled. Examples 2.1 and 2.2 illustrate excess imputation credits.

2.10 A taxpayer calculates any excess imputation credits in the same way as they currently calculate any excess private health insurance tax offset. ***[Schedule 2, item 1, subsection 4-10(3A), items 2 and 3]***

2.11 Imputation credits subject to these rules are certain franking rebates found in Part IIIAA of the ITAA 1936 ***[Schedule 2, item 6, subsection 67-25(1)]***. If the taxpayer is not entitled to a franking rebate because, for example, it is an exempt taxpayer, there are no excess imputation credits to refund.

Who is entitled to refunds of excess imputation credits?

2.12 The new law, found in Division 67 of the ITAA 1997, provides that once the income tax liability of taxpayers entitled to the refund has been offset, excess imputation credits will be refunded. The taxpayers entitled to the refund are resident:

- individuals;
- trustees assessed on a resident beneficiary's share of trust income;
- superannuation funds;
- approved deposit funds;
- life assurance companies;
- registered organisations (e.g. friendly societies); and
- pooled superannuation trusts.

2.13 Previously, the only tax offset that was refundable was the private health insurance tax offset. The new law creates an expanded class of tax offsets that are subject to the refundable tax offset rules ***[Schedule 2, items 4 and 5, section 61-335; item 6, subsection 67-20]***. These tax offsets are imputation credits and the private health insurance tax offset ***[section 67-25]***.

2.14 Imputation credits that are refundable are franking rebates available under the following provisions of the ITAA 1936:

- section 160AQU (applicable to dividends paid directly to a shareholder eligible to receive a franking rebate);
- section 160AQX (beneficiaries of a trust);
- section 160AQY (trustees);
- section 160AQYA (superannuation fund, approved deposit fund and pooled superannuation trust beneficiaries and partners);
- section 160AQZA (life assurance company beneficiaries and partners);
- section 160AQZ (other partners); and
- section 160ASEP (venture capital franking rebates available to certain shareholders of pooled development funds).

[Subsection 67-25(1)]

2.15 Trustees entitled to a franking rebate under section 160AQY can receive a refund of any excess imputation credits only if they are liable to be assessed under section 98 or 99 of the ITAA 1936. If they are liable to be assessed under any other provision, for example section 99A, then they cannot receive a refund of any excess imputation credits. This is because the measure is aimed at ensuring that taxpayers are taxed at their marginal tax rate on dividend income. Under section 99A, the trustee is assessed at a tax rate that is not linked to a beneficiary. ***[Subsection 67-25(1)]***

2.16 Individuals entitled to imputation credits calculate their refund under this measure as follows ***[Schedule 2, item 6, section 67-30]***:

Step 1. Calculate tax payable on taxable income.

Step 2. Reduce tax payable by tax offsets to which they are entitled (except the private health insurance tax offset and imputation credits).

Step 3. Add other tax liabilities (e.g. Medicare levy and HECS repayments).

Step 4. Deduct any refundable tax offset amount (i.e. private health insurance tax offset and imputation credit amount).

Step 5. Deduct any tax instalment (PAYE) deductions or similar payments of tax relating to the income year.

If the result from step 4 or step 5 (if applicable) is negative, the taxpayer is entitled to a refund equal to that amount ***[Schedule 2, item 6, section 67-35]***.

Example 2.1

Peter is resident in Australia for tax purposes. His tax on taxable income is $406. He is entitled to the full low-income rebate (of $150) and a $100 private health insurance rebate. He also is entitled to a $250 franking rebate for dividends paid on or after 1 July 2000. He is under the Medicare levy threshold.

His refund is calculated as follows:

tax on taxable income	$406
less amount of low income rebate	–$150
less amount of private health insurance rebate	–$100
less amount of imputation credits	–$250
Refund	$94

Therefore, Peter is entitled to a refund of $94, which is the amount of his excess imputation credits. (The private health insurance rebate and imputation credits are separated in this example for ease of recognition.)

Example 2.2

Deborah is resident in Australia and employed by a law firm. She is a late balancing taxpayer. Her tax on taxable income is $11,500. Her Medicare levy and HECS repayments are $1,000. Her employer deducted $11,000 PAYE from her salary and wages. She is entitled to foreign tax credits of $100 and a dependant spouse rebate of $1,300. She is also entitled to a $200 franking rebate for dividends received on or after 1 July 2000, and a $200 franking rebate for dividends received before 1 July 2000.

She works out her refund or tax payable as follows:

tax on taxable income	$11,500
less dependant spouse rebate	–$1,300
less foreign tax credits	–$100
less franking rebate (dividends paid before 1/7/2000)	–$200
add Medicare levy and HECS repayments	$1,000
less franking rebate (dividends paid on or after 1/7/2000)	–$200
less PAYE credits	–$11,000
Refund	$300

Therefore, Deborah is entitled to a refund of $300. (Because Deborah's total tax payable exceeds the amount of her imputation credits in relation to dividends paid on or after 1 July 2000, the measures do not change the amount of the refund she is entitled to receive.)

Application and transitional provisions

2.17 This measure applies to imputation credits that relate to dividends paid on or after 1 July 2000. For most taxpayers, this means that it applies from the start of their 2000-2001 income year. ***[Schedule 2, item 7]***

2.18 If the imputation credit is obtained by a beneficiary of a trust or a partner in a partnership because the trust or partnership is paid a franked dividend, the measure applies only if the original dividend is paid on or after 1 July 2000.

2.19 This means that where, for example, a trustee distributes an amount to a beneficiary on or after 1 July 2000 and the distribution represents a franked dividend paid before that date, the beneficiary will not be entitled to a refund of imputation credits relating to the trust distribution.

Consequential amendments

2.20 There are no consequential amendments relating to this measure.

Chapter 3
Company rate change (franking account and infrastructure borrowings rebate consequentials)

Outline of Chapter

3.1 This Chapter explains the amendments made in Schedules 3 and 4 to this Bill to the dividend imputation and infrastructure borrowings rebate provisions as a consequence of the changes to the company tax rate made by the Income Tax Rates Bill No. 1.

3.2 In particular, this Bill inserts Division 14 into Part IIIAA of the ITAA 1936 which generally deals with the conversion of those aspects of the imputation system that reflect an underlying company tax rate of 36% so that they reflect an underlying rate of 34% instead. This rate is proposed to be the company tax rate in the 2000-2001 income year.

3.3 This Bill also amends section 159GZZZZG of the ITAA 1936 to ensure that the infrastructure borrowings rebate is calculated by reference to the new company tax rates.

3.4 The changes generally apply to the imputation system from 1 July 2000 and to dividends paid on or after that date. The changes to the infrastructure borrowings rebate apply to the 2000-2001 income year for the 34% rate and from the 2001-2002 income year for the 30% rate.

Context of Reform

3.5 The reductions in the company tax rate provided for in the Income Tax Rates Bill No. 1 are a key component of the New *Business* Tax System announced in Treasurer's Press Release No. 58 of 21 September 1999 (refer to Attachment A).

3.6 The reduced company tax rate will provide Australia with an internationally competitive company tax rate. The eventual reduction of the company tax rate to 30% will bring the Australian rate into line with rates in other countries in the Asia Pacific region and will boost investment in Australia.

3.7 As a result of the reduction in the company tax rate for the 2000-2001 and later income years, consequential amendments are needed to the dividend imputation and infrastructure borrowings rebate provisions.

3.8 The amendments made to the imputation system in this Bill are generally limited to the class C franking account and transactions affecting that account. The class C franking account currently reflects the 36% company tax rate.

3.9 Amendments affecting the class A franking account to reflect proposed changes to the taxation of life insurance companies will be addressed in a future Bill. The class A franking account reflects the 39% rate. A life insurance company will no longer pay tax on any part of its taxable income at the 39% rate as a result of the proposed changes to the taxation of life insurance companies.

Summary of new law

3.10 In broad terms, the amendments to the imputation system will:

- convert existing class C franking account balances (which are based on an underlying tax rate of 36%) so that they are based on the new company tax rate of 34% from 1 July 2000;
- generally convert franking credits and franking debits arising on or after 1 July 2000 to reflect the new company tax rate of 34% (if the credits and debits are based on another underlying company tax rate); and
- provide that most franked dividends paid on or after 1 July 2000 carry underlying imputation credits reflecting a 34% rate.

Comparison of key features of new law and current law

New Law	*Current Law*
Most franking credit and debit entries made to a company's franking account will be calculated by reference to the 34% company tax rate.	Most franking credit and debit entries made to a company's franking account are calculated by reference to the 36% company tax rate.
Most franking rebates will be calculated by reference to the 34% company tax rate.	Most franking rebates are calculated by reference to the 36% company tax rate.

Detailed explanation of new law

Conversion of the class C franking account

3.11 Companies will be required to convert their class C franking account on 1 July 2000 to take account of the new 34% company tax rate.

3.12 A company converts its class C franking account at the start of 1 July 2000 by:

- cancelling any class C franking surplus or deficit existing at that time with:
  - in the case of a surplus, an offsetting franking debit equal to the surplus; or
  - in the case of a deficit, an offsetting franking credit equal to the deficit; and
- reinstating any class C franking surplus or deficit with a class C franking credit or debit equal to the offsetting franking debit or credit adjusted by the factor:

$$\frac{36}{64} \times \frac{66}{34}$$

[Schedule 3, item 13, sections 160ATA and 160ATB]

3.13 For a company with a franking year that starts on 1 July 2000, the conversion of the class C franking account occurs after any franking credit arises which carries forward a franking surplus from the previous franking year. ***[Item 13, subsection 160ATA(2)]***

3.14 Despite this conversion, the account will be retained and have the same name – the class C franking account. This avoids the need for extensive amendments to the imputation system to reflect an account with a new name.

Example 3.1

Street Smart Ltd maintains a class C franking account and has a franking year of 1 June to 31 May. On 1 July 2000 its class C franking account has a deficit balance of $500. It converts its account to reflect the changed company tax rate as follows:

• class C franking account balance	–$500.00
• offsetting class C franking credit	$500.00
• reinstating class C franking debit	–$545.96

$$\left[\$500 \times \frac{36}{64} \times \frac{66}{34}\right]$$

If, on the other hand, its class C franking account had a surplus balance of $630, the company would convert its franking account as follows:

- class C franking account balance $630.00
- offsetting class C franking debit –$630.00
- reinstating class C franking credit $687.90
  $\left[\$630 \times \frac{36}{64} \times \frac{66}{34}\right]$

Franked dividends paid on or after 1 July 2000 will reflect the new rate

3.15 A further consequence of the change in the company tax rate is that all franked dividends paid on or after 1 July 2000 will carry imputation credits reflecting the 34% company tax rate. This means that franking rebates claimed by shareholders on a class C franked dividend paid on or after 1 July 2000 will be based on the 34% company tax rate. This change also applies to franking rebates claimed by beneficiaries and partners because a class C franked dividend is paid to a trust or a partnership on or after 1 July 2000.

3.16 This result is achieved by omitting the reference to 36% in paragraph (cb) of the definition of 'applicable general company tax rate' in section 160APA of the ITAA 1936 and replacing it with 34%. ***[Item 2]***

Example 3.2

Sebastian is a shareholder in Big Jean Ltd. On 1 July 2000, Big Jean pays a $200 fully franked class C dividend to Sebastian.

The applicable general company tax rate for the purposes of the payment of the franked dividend is 34%. This means the additional amount included in Sebastian's assessable income under subsection 160AQT(1AB) is equal to $200 × 34/66, or $103.03. Sebastian is also entitled to a franking rebate (i.e. a tax offset) of the same amount under section 160AQU.

3.17 The amendments will also ensure that shareholders receive clear information about the nature of their franked dividends, particularly given that the class C franking account name will be maintained. The shareholder statement in relation to a dividend paid on or after 1 July 2000 must include the gross up amount for the dividend (calculated under subsection 160AQT(1AB)) and specify that the applicable company tax rate used to calculate the gross up amount is 34%. ***[Item 4, subparagraph 160AQH(1)(b)(iva)]***

Converting franking credits and debits reflecting the 34% company tax rate

3.18 Once franking accounts are converted to reflect the new 34% company tax rate, it is necessary to ensure that franking credits or debits arising on or after 1 July 2000 reflect the 34% company tax rate. This means that franking credits and franking debits that are based on a different underlying rate will generally be converted to equivalent credits and debits based on the new rate. ***[Item 13, section 160ATD]***

3.19 In summary:

- class A franking credits and debits (other than those for life insurance companies) are converted into equivalent class C franking credits and debits using the factor:

$$\frac{39}{61} \times \frac{66}{34}$$

- class B franking credits and debits are converted into equivalent class C franking credits and debits using the factor:

$$\frac{33}{67} \times \frac{66}{34}$$

- class C franking credits and debits that have been calculated by reference to the 36% company tax rate are converted into equivalent 34% class C franking credits and debits using the factor:

$$\frac{36}{64} \times \frac{66}{34}$$

[Item 13, table in subsection 160ATD(1)]

3.20 Class A franking credits and debits for life insurance companies are not converted ***[item 13, table in subsection 160ATD(1), items 1 and 2]***. These credits and debits will be converted as part of proposed changes to the taxation of life insurance companies that will be addressed in a later Bill.

3.21 However, not all old class A, B, or C franking credits or debits arising on or after 1 July 2000 are necessarily converted. Those that are not converted include:

- franking credits and debits arising under Division 14. These franking credits and debits arise as part of the conversion to reflect the new company tax rate. To convert them again would frustrate the conversion;

- franking credits arising under section 160APL. These franking credits, which carry forward franking surpluses from previous franking years, are already taken into account in the conversion process (see paragraph 3.13); and
- franking debits arising under sections 160APX (underfranking debits), 160AQB (payment of franked dividends), 160AQCB, 160AQCBA, 160AQCC, 160AQCNA, 160AQCNB and 160AQCNC (all of which arise in relation to dividend streaming arrangements). It is unnecessary to convert these franking debits because they will already be calculated by reference to the 34% rate if they arise on or after 1 July 2000.

[Item 13, subsection 160ATD(1)]

3.22 A critical part of maintaining the class C franking account name is to identify those credits and debits that arise at a 36% rate. Only those credits and debits should be converted – those reflecting a 34% rate should not be converted.

3.23 To achieve this, the Bill stipulates when a credit or debit ***reflects an applicable general company tax rate of 36%*** ***[item 13, subsection 160ATD(2)]***. The most common case of where a credit or debit reflects an applicable general company tax rate of 36% is where that rate is used in working out the amount of the credit or debit (including where that rate is used in working out an 'adjusted amount' for the purposes of working out the amount of a credit or a debit). An example is a franking credit arising from a payment of tax at the 36% rate.

Companies ceasing to be life insurance companies

3.24 A company which ceases to be a life insurance company on or after 1 July 2000 will have its class A franking surplus or deficit converted and moved to the class C franking account at the time the company ceases to be a life insurance company. In order for the conversion to take place, it is necessary that the company still exists after it ceases to be a life insurance company. ***[Item 13, section 160ATE]***

3.25 The process for converting the accounts is similar to the conversion process explained in paragraphs 3.11 to 3.14 for the conversion of class C franking accounts.

3.26 Section 160ATE will be affected by the proposed changes to the taxation of life insurance companies to be addressed in a future Bill.

Changes to provisions that dealt with the conversion to the 36% rate

3.27 Division 13 of Part IIIAA of the ITAA 1936 contains provisions that deal with:

- the conversion of class A and B franking credits and debits into equivalent class C franking credits and debits; and
- companies ceasing to be life insurance companies,

following the increase in the company tax rate from 33% to 36% from the 1995-1996 income year. A new provision has been inserted to ensure that these provisions in Division 13 do not operate in relation to events occurring on or after 1 July 2000 ***[item 6, section 160ASEA]***. Sections 160ATD and 160ATE (see paragraphs 3.18 to 3.26) will apply instead.

3.28 In addition, amendments have been made to Division 13 to ensure that other provisions within it continue to operate appropriately and reflect the 34% company tax rate. ***[Items 7 to 12]***

Changes to the required franking amount rules

3.29 The 'required franking amount' represents the minimum extent to which a dividend should be franked having regard to the balance in the company's franking account at the time the dividend is paid. When a company pays a franked dividend, the franking account will be debited at least to the extent of the required franking amount.

3.30 The required franking amount of a dividend can be affected by the required franking amount or the franked amount of an earlier dividend. In particular, the required franking amount rules effectively require dividends paid under a single resolution to be franked to the same extent. This is achieved by calculating the required franking amount of a dividend by reference to the franking surplus on the 'reckoning day' for that dividend. For a dividend paid under a resolution, the reckoning day is the day on which the first dividend in the resolution is paid.

3.31 Therefore, where dividends under a resolution are paid both before and after 1 July 2000 anomalies could arise. The required franking amount of a dividend paid on or after 1 July 2000 that will carry imputation credits at a 34% rate would be worked out by reference to a franking surplus based on the 36% rate.

3.32 To address this situation 3 specific amendments have been made:

- providing for resolution splitting for dividends straddling 1 July 2000;
- allowing variations to dividend declarations; and
- providing modifications to the rules relating to over-franked earlier dividends.

Resolution splitting

3.33 Where a company:

- pays a number of class C franked dividends under a resolution made before 1 July 2000; and
- some of the dividends (first series dividends) are paid before that date, while other dividends (second series dividends) are paid after that date;

the first series dividends and second series dividends will be taken to have been made under separate resolutions. ***[Item 13, subsection 160ATF(1) and paragraph 160ATF(2)(a)]***

3.34 The effect of this rule is that the second series dividends will have their required franking amount worked out on the basis of a franking surplus that has been converted on 1 July 2000 to a 34% rate.

Example 3.3

Tree Surgeons Ltd makes a resolution on 10 December 1999 under which dividends are payable on 5 May 2000 (dividend 1) and 5 November 2000 (dividend 2). The reckoning day for these dividends is therefore 5 May 2000.

Under subsection 160ATF(1), this resolution will be split into 2 separate resolutions – one dealing with dividend 1 and the other dealing with dividend 2. The reckoning day for dividend 1 is still 5 May 2000 and the calculation of the required franking amount will remain substantially unaltered. The reckoning day for dividend 2 will now be 5 November 2000 and the required franking amount will be worked out on the basis of the franking surplus on that day. That surplus will reflect the 34% rate, just as the imputation credits underlying the franked dividend will.

Declaration variations

3.35 If a company has already made a declaration under section 160AQF in relation to the dividends, the second series dividends may be franked to a different extent than that set out under the new required franking amounts for those dividends.

3.36 To deal with this, the original declaration made under section 160AQF will be taken to have applied to the first series dividends and the company will be permitted to make a further declaration in respect of the second series dividends. ***[Item 13, paragraph 160ATF(2)(b)]***

3.37 However, if the company makes no declaration in respect of the second series dividends before the new reckoning day for those dividends, the dividends will be taken to be franked to the same percentage as the first series dividends. ***[Item 13, paragraph 160ATF(2)(c)]***

Example 3.4

> Continuing from Example 3.3, Tree Surgeons may make a new declaration for dividend 2 before 5 November 2000 if it had previously made a declaration in relation to dividends 1 and 2. If Tree Surgeons does not make a new declaration for dividend 2, the declaration originally made for both dividends 1 and 2 will stand for dividend 2.

3.38 Circumstances may also arise where, before 1 July 2000, a company declares dividends under a resolution to be franked based on the 36% company tax rate, but no dividend will be paid under that resolution until on or after 1 July 2000.

3.39 Ordinarily, section 160AQF declarations cannot be varied because of subsection 160AQF(2). However, an exception will be made where a resolution is made before 1 July 2000 but no dividends under the resolution are paid until on or after that date. In these cases, any declaration can be varied before the reckoning day of the dividend to take into account the new 34% company tax rate. ***[Item 13, section 160ATG]***

Modifications to rules for over-franked earlier dividends

3.40 Subsection 160AQE(3) provides that if a company over-franks a dividend (called the 'earlier franked dividend' in that subsection), and there is a committed future dividend, that committed future dividend must be franked to at least the same extent.

3.41 It could be the case that the committed future dividend (called the 'current dividend' in subsection 160AQE(3)) may have a reckoning day after 1 July 2000, but the earlier franked dividend has a reckoning day before that time. This means that the required franking amount of the current dividend may be affected by the franked amount of the earlier dividend, which will not reflect the new 34% company tax rate.

3.42 To prevent the required franking amount of the current dividend being distorted by the franked amount of the earlier dividend, the amendments will convert franked amounts of earlier dividends into amounts reflecting a 34% rate. ***[Item 13, section 160ATH]***

Modifications to the 'equal franking rule'

3.43 Section 160AQG effectively provides that dividends that are part of a combined class of dividends must be equally franked. If this is not the case, then the dividends will all be treated as though they had been paid under the resolution relating to the first dividend of the class to ensure that those dividends are equally franked. The purpose of this section is to prevent blatant dividend streaming arrangements.

3.44 A new provision has been inserted to ensure that companies are not inappropriately caught by section 160AQG where a combined class of dividends paid during a franking year straddles 1 July 2000. The provision splits the franking year (other than one starting on 1 July 2000) into 2 separate franking years – the first ending on 30 June 2000 and the second starting on 1 July 2000. ***[Item 3, subsection 160AQG(4)]***

3.45 The effect of this amendment is that section 160AQG will apply separately in respect of the 2 split franking years. This rule means that companies will not be subject to section 160AQG if dividends are not equally franked only because of the rules relating to the conversion of franking accounts to reflect the new company tax rate.

3.46 Notwithstanding these amendments, companies that enter into a strategy to stream franking credits can still expect to attract the operation of the various anti-streaming rules elsewhere in Part IIIAA.

Estimated debit determinations

3.47 A company can request an estimated debit determination if it can foresee a refund of company tax in certain circumstances. An estimated debit determination will give rise to a franking debit. This means that dividends can be franked to take account of the estimated debit.

3.48 Under the current law, a taxpayer may apply to the Commissioner for a class C estimated debit determination under section 160AQDAA. However, if the Commissioner does not make a declaration within 21 days, the Commissioner is deemed to have made a determination of the amount requested in the application.

3.49 The period of 21 days means that applications made between 9 June 2000 and 1 July 2000 may be based on a 36% or a 34% rate of company tax. To accommodate this situation, the amendments allow a company to specify in its application whether the application is based on the 34% or 36% tax rate. However, if the company does not specify a tax rate, the application will be treated as though it were based on the 36% tax rate. ***[Item 13, section 160ATI]***

3.50 Companies should ensure any application made on or after 1 July 2000 is based on the 34% company tax rate.

Changes related to venture capital sub-accounts

3.51 This Bill makes changes to venture capital sub-accounts, which basically reflect the general changes outlined in relation to class C franking accounts above. Venture capital sub-accounts are being introduced in this Bill and are explained in greater detail in Chapter 4.

Changing other references to a 36% rate in the imputation provisions

3.52 The following references in the imputation provisions that rely on a company tax rate of 36% will be replaced by references relying on the new rate of 34%:

- in paragraph (baa) of the definition of 'applicable general company tax rate' (which applies in relation to a company's liability to pay class C franking deficit tax or class C deficit deferral tax) in section 160APA ***[item 1]***; and

- in the formula in subsection 160AQJC(4) which calculates the 'gross class C deficit deferral amount' for the purposes of working out liabilities to class C deficit deferral tax ***[item 5]***.

Amendments to the infrastructure borrowings rebate provisions

3.53 Division 16L of the ITAA 1936 is designed to encourage private investment in the construction of certain public infrastructure projects. The Division effectively transfers the benefit of interest deductions from borrowers to lenders in these projects. Under that Division, taxpayers may currently elect to benefit from a tax rebate in relation to the interest under a loan at a rate of 36% – that is, the current company tax rate.

3.54 The references to the 36% rate in section 159GZZZZG are amended by this Bill to account for the change in the company tax rate to 34% for the 2000-2001 income year. ***[Schedule 4, items 1 to 4]***

3.55 The references to the 34% rate will then be amended to take account of the change in the company tax rate to 30% for the 2001-2002 and later income years. ***[Schedule 4, items 6 to 9]***

Application and transitional provisions

3.56 The following amendments apply to relevant dividends paid on or after 1 July 2000:

- item 2 of Schedule 3, which provides for the change in the applicable general company tax rate for the payment of class C franked dividends and for trust amounts and partnership amounts related to the payment of class C franked dividends (see paragraphs 3.15 and 3.16) ***[Schedule 3, subitem 14(2)]***;

- item 4 of Schedule 3, which modifies the requirements for dividend statements (see paragraph 3.17) ***[subitem 14(3)]***; and
- items 7 to 12 of Schedule 3, which modify the operation of Division 13 of Part IIIAA to reflect the new company tax rate of 34% (see paragraph 3.28) ***[subitems 14(5) and 14(6)]***.

3.57 The amendments in items 1 and 5 of Schedule 3 that reflect the new company tax rate of 34% for the purposes of franking deficit tax and deficit deferral tax (see paragraph 3.52) apply to:

- franking deficit tax for franking years ending on or after 1 July 2000; and
- deficit deferral tax in relation to company tax instalments paid during a franking year ending on or after 1 July 2000.

[Subitems 14(1) and 14(4)]

3.58 The amendments to the infrastructure borrowings rebate provisions to reflect the new company tax rate of 34% in items 1 to 4 of Schedule 4 (see paragraph 3.54) apply to assessments for the 2000-2001 income year. ***[Schedule 4, item 5]***

3.59 The amendments to the infrastructure borrowings rebate provisions to reflect the new company tax rate of 30% in items 6 to 9 of Schedule 4 (see paragraph 3.55) apply to assessments for the 2001-2002 and later income years. ***[Item 10]***

Consequential amendments

3.60 There are no other consequential amendments.

Chapter 4
Venture capital franking rebates

Outline of Chapter

4.1 This Chapter explains the measure in Schedule 5 to this Bill, which is designed to encourage venture capital investment in Australia. The measure allows resident complying superannuation funds (and like entities) a special franking rebate – the venture capital franking rebate – which enables them to receive venture capital gains free of tax through PDFs.

4.2 The Chapter explains who is eligible for the measure and how the venture capital franking rebate is calculated. It also explains the requirements and administrative procedures for PDFs that wish to 'venture capital frank' dividends and thereby provide the concessional tax treatment for their superannuation fund (and like entity) investors.

4.3 The Chapter also explains the operation of the New Business Tax System (Venture Capital Deficit Tax) Bill 1999, a complementary Bill under which venture capital deficit tax is imposed to ensure that a PDF does not venture capital frank its dividends beyond its permissible limit.

Context of Reform

4.4 Under the current law, tax incentives are provided for investors in PDFs to encourage investment in innovative Australian firms. This measure further promotes investment in these entities by specifically encouraging superannuation funds (and like entities) to invest in PDFs.

4.5 Currently, unfranked dividends paid by a PDF are exempt from income tax. The franked portion of the dividend is also exempt unless the recipient elects to include the dividend in assessable income to obtain the franking rebate. Exempting venture capital gains received through PDFs will further encourage Australian superannuation funds to invest in venture capital.

Summary of new law

4.6 Eligible superannuation entities will receive a rebate for CGT paid by a PDF on venture capital investments.

4.7 To trace the CGT paid by the PDF through to its shareholders, the concept of venture capital franked dividends has been introduced. In order to provide a rebate for the CGT paid and exempt the underlying income, it is necessary for the PDF to identify tax paid on venture capital gains as venture capital credits. To distribute these credits, the PDF must record and keep account of its available venture capital franking credits in a venture capital sub-account, which is a sub-account of its class C franking account.

4.8 Venture capital credits are allocated equally to all shareholders when the PDF uses those credits to venture capital frank a dividend.

4.9 For eligible superannuation funds (and like entities) that receive a venture capital franked dividend, the dividend will be exempt income. However, the shareholder will also receive a rebate for the attached venture capital credits which effectively exempts from tax the underlying venture capital gain.

4.10 To prevent a PDF from over-distributing venture capital credits, a tax is imposed on deficits in venture capital sub-accounts at the end of a franking year. This tax, *venture capital deficit tax*, is imposed by a separate Bill – the New Business Tax System (Venture Capital Deficit Tax) Bill 1999.

Comparison of key features of new law and current law

4.11 This measure allows PDFs to provide a rebate for CGT paid on venture capital investments to their superannuation fund (and like entities) shareholders. There is currently no comparable measure available for these investors.

New Law	*Current Law*
Eligible shareholders in a PDF are entitled to a rebate for capital gains tax paid by the PDF on venture capital investments.	CGT paid by a PDF is not refunded to its shareholders.
Venture capital franked dividends: • are exempt from income tax; and • provide a venture capital rebate, for eligible shareholders.	Currently PDF dividends are only identified as franked or unfranked. Unfranked dividends are exempt from income tax and franked dividends are either exempt or assessable at the election of the taxpayer. If assessable, the taxpayer receives a rebate. The dividend never produces a rebate whilst being exempt income.

New Law	*Current Law*
A PDF may keep a venture capital sub-account in its class C franking account if it so chooses, which enables it to accrue venture capital credits and pay venture capital franked dividends.	PDFs keep only a class C franking account and do not separately identify tax paid on venture capital gains.
The PDF is liable to pay venture capital deficit tax on a deficit in its venture capital sub-account at the end of the franking year.	There is no corresponding measure.

Detailed explanation of new law

How does the measure apply to shareholders of a PDF?

4.12 Shareholders in a PDF who are eligible for the venture capital franking rebate receive concessional tax treatment on venture capital franked dividends. These shareholders are superannuation funds (and like entities) listed at paragraphs 4.18 and 4.20.

4.13 A ***venture capital franked dividend*** is a dividend that has been declared as such by the PDF ***[section 160ASEL]***. When the shareholder is paid a dividend, they will receive a distribution statement that will identify the class C and the venture capital franked amounts of the dividend ***[subparagraph 160AQH(1)(b)(vii)]***.

4.14 The venture capital franked amount of the dividend is only relevant for shareholders who are eligible for the venture capital rebate. Therefore, if the shareholder is not an eligible shareholder they simply ignore the venture capital franked amount of the dividend.

4.15 If the shareholder is an eligible shareholder the dividend will receive the tax treatment indicated in Table 4.1.

Table 4.1: The tax treatment of dividends paid to eligible shareholders

Dividend amount	*Tax treatment*	*Rebate*
Unfranked amount.	Exempt income ***[subsection 124ZM(1)]***.	No rebate.
Ordinary class C franked amount.	Exempt income ***[subsection 124ZM(2)]***; or May be included in assessable income at the taxpayer's election ***[subsection 124ZM(3)]***.	No rebate; or Franking rebate if included in assessable income ***[section 160AQU]***.

Dividend amount	***Tax treatment***	***Rebate***
Venture capital franked amount for which the eligible entity may obtain a venture capital franking rebate.	Exempt income ***[subsections 124ZM(1C) and (1D)].***	Venture capital rebate* ***[section 160ASEP].***

* The amount of the venture capital rebate may vary depending on the category of eligible shareholder.

4.16 For the purposes of Table 4.1, the ordinary class C franked amount of a dividend is the class C franked amount reduced by the venture capital franked amount, and increased by any venture capital franked amount for which the shareholder does not receive a rebate.

4.17 The class C franked amount of the dividend is reduced by the venture capital franked amount of the dividend to prevent the taxpayer from obtaining both a venture capital franking rebate and class C franking rebate in relation to the same portion of the dividend. ***[Subsection 160AQT(6)]***

Who is an eligible shareholder?

4.18 The following resident shareholders are eligible for venture capital rebates:

- complying superannuation funds ***[paragraph 160ASEO(1)(a)]***;
- complying ADFs ***[paragraph 160ASEO(1)(b)]***; and
- pooled superannuation trusts ***[paragraph 160ASEO(1)(c)].***

4.19 A complying superannuation fund or complying ADF is not eligible if the fund is a self managed superannuation fund (within the meaning of the *Superannuation Industry Act 1993*). ***[Subsection 160ASEO(2)]***

4.20 Life assurance companies and registered organisations may engage in some superannuation business. Consequently they are also eligible for the venture capital franking rebate ***[paragraphs 160ASEO(1)(d) and (e)]***. However, the amount of the rebate available for these eligible shareholders may be limited. The rebate will be adjusted to reflect the extent to which the share on which the venture capital franked dividend was paid is referable to their superannuation business.

4.21 The rebate is not available if the dividend is received by the eligible shareholder through a partnership or trust or, for example, if the dividend is part of a dividend stripping operation. ***[Paragraphs 160ASEP(1)(d) and (g)]***

How is the venture capital franking rebate calculated?

4.22 How the rebate is calculated varies according to the category of eligible shareholder. For example, the rebate is calculated differently for life assurance companies and registered organisations. Therefore, to correctly calculate the rebate it is first necessary to identify the category of eligible shareholder.

Complying superannuation funds, complying ADFs and pooled superannuation trusts

4.23 The rebate is calculated in the same way for:

- complying superannuation funds;
- complying ADFs; and
- pooled superannuation trusts.

4.24 For these taxpayers, the rebate is:

$$\text{venture capital franked amount of the dividend} \times \frac{\text{company tax rate}}{1 - \text{company tax rate}}$$

[Subsection 160ASEP(1)]

4.25 This formula identifies the tax paid by the PDF in relation to the venture capital franked portion of the dividend.

4.26 This method of calculating the venture capital rebate is consistent with that for franking rebates for ordinary class C franked dividends.

Example 4.1: Calculating the venture capital rebate

An eligible shareholder receives a total of $400 venture capital franked dividends in the income year. Assume the company tax rate is 30 %.

The amount of the rebate is:

$$\$400 \times \frac{30\%}{100\% - 30\%}$$

$$= \$400 \times \frac{30\%}{70\%}$$

$$= \$171.43$$

Life assurance companies

4.27 The rebate for life assurance companies is initially calculated in the same way as the rebate for other eligible shareholders other than registered organisations. This amount is then adjusted to reflect that portion of the rebate that is referable to the superannuation business of the company. ***[Subsection 160ASEP(2)]***

4.28 Under the current tax law life assurance companies allocate their assessable income to 4 classes of income, one of which is its complying superannuation/roll-over annuity class, or CS/RA class. This class of income represents the income from the superannuation business of the company.

4.29 Therefore, for life assurance companies, the rebate is:

$$\text{venture capital franked amount of the dividend} \times \frac{\text{company tax rate}}{1 - \text{company tax rate}} \times \frac{\text{CS/RA income}}{\text{total income}}$$

Example 4.2: Calculating the venture capital rebate for life assurance companies

A life assurance company receives $100,000 of venture capital franked dividends in a year of income. The CS/RA income of the company is $500,000 and the total income of the company is $1,000,000 for that year. Assume the company tax rate for the year in question is 30%.

The rebate is calculated as follows:

$$\$100{,}000 \times \frac{30\%}{100\% - 30\%} \times \frac{\$500{,}000}{\$1{,}000{,}000}$$

$$= \$100{,}000 \times \frac{30\%}{70\%} \times \frac{1}{2}$$

$$= \$42{,}857.14 \times \frac{1}{2}$$

$$= \$21{,}428.57$$

Registered organisations

4.30 If the eligible taxpayer is a registered organisation it will receive the rebate only if the venture capital franked dividend is income derived from its CS/RA business. ***[Subsection 160ASEP(3)]***

4.31 Income from the CS/RA business of the registered organisation is income that flows from its CS/RA assets. Therefore, the registered organisation must trace the relevant shareholding under which the venture capital franked dividend is paid to a CS/RA asset.

4.32 If the venture capital franked dividend is income from its CS/RA business, the rebate will be calculated as for other eligible shareholders other than life assurance companies in accordance with the following formula:

$$\text{venture capital franked amount of the dividend} \times \frac{\text{company tax rate}}{1 - \text{company tax rate}}$$

How does the measure apply to the PDF?

4.33 To encourage investment by eligible shareholders, PDFs may pay venture capital franked dividends. This allows them to provide a rebate to their shareholders for CGT they have paid on venture capital gains.

What is a venture capital gain?

4.34 Venture capital gains are those gains to which the concessional tax treatment applies. They are capital gains triggered by a CGT event – as defined in Division 104 of the ITAA 1997 – made by a PDF on 'qualifying SME investments'.

4.35 A ***qualifying SME investment*** is an investment made by a PDF in accordance with the *Pooled Development Funds Act 1992* other than an unregulated investment ***[section 160APA]***. Broadly speaking, it is an investment that injects new equity into an Australian small or medium enterprise engaged in innovative business.

4.36 Tax paid on these gains produce venture capital credits which are used to venture capital frank dividends. Venture capital credits and debits are recorded in a venture capital sub-account kept by the PDF.

The venture capital sub-account

4.37 PDFs are not required to keep a venture capital sub-account. ***[Section 160ASEB]***

4.38 However, the PDF must keep a venture capital sub-account if it wishes to pay venture capital franked dividends. ***[Section 160ASEL]***

4.39 The venture capital sub-account is so called as it represents a sub-account of the class C franking account. It is not a separate franking account.

How do you calculate the balance in the venture capital sub-account?

4.40 The balance in the venture capital sub-account at any point in time is the difference between:

- all venture capital credits to the sub-account during the franking year up to the particular point in time; and
- all venture capital debits to the sub-account during the franking year up to the particular point in time.

4.41 Where there have been more venture capital credits than debits to the account during the franking year up to the particular point in time (i.e. there is an excess of venture capital credits over venture capital debits) the account will be in surplus to the extent of the excess. ***[Subsection 160ASEC(1)]***

4.42 Where there have been more venture capital debits than credits to the account during the franking year up to the particular point in time (i.e. there is an excess of venture capital debits over venture capital credits) the account will be in deficit to the extent of the excess. ***[Subsection 160ASEC(2)]***

4.43 There is not necessarily a correlation between an amount of deficit in the venture capital sub-account and a surplus in the class C franking account, or *vice versa*. It is quite possible for one to be in deficit whilst the other is in surplus. ***[Subsection 160ASEC(3)]***

4.44 However, deficits in both the venture capital sub-account and the class C franking account may be related. Both may have been created by the one event.

Venture capital deficit tax

4.45 If a PDF's venture capital sub-account is in deficit at the end of the franking year, the PDF is liable to pay venture capital deficit tax. ***[Section 160ASEN]***

<u>How is the venture capital deficit tax determined?</u>

4.46 The balance of the PDF's venture capital sub-account at the end of the franking year for the purposes of determining liability to venture capital deficit tax is calculated differently from the manner in which the balance is ordinarily ascertained.

4.47 The balance at the end of the year is calculated as follows:

Step 1 – the total of all venture capital franking credits to the venture capital sub-account in the franking year;

minus

Step 2 – the total of all venture capital debits to the venture capital sub-account during the franking year;

minus

Step 3 – any venture capital debits that would arise in relation to a refund or refunds of income tax received within 6 months of the end of the franking year.

[Subsection 4(2) of the New Business Tax System (Venture Capital Deficit Tax) Bill 1999]

4.48 Including debits received within 6 months of the end of a franking year in determining the balance of the sub-account at the end of that year is a simple method of implementing a type of deficit deferral tax. That tax is designed to prevent a company bringing forward tax payments, and consequently franking credits, to avoid franking deficit tax for a year, only to have the brought-forward tax refunded at the beginning of the following year.

How much venture capital deficit tax is payable?

4.49 The amount of the deficit tax payable will vary depending on the relative size of the deficit and the amount of venture capital credits for that franking year.

4.50 If the deficit is equal to or less than 10% of the PDF's total venture capital credits for the franking year, the debit is calculated in accordance with the following formula (the '100% formula'):

$$\text{venture capital sub-account deficit} \times \frac{\text{company tax rate}}{1 - \text{company tax rate}}$$

[Subsection 5(1) of the New Business Tax System (Venture Capital Deficit Tax) Bill 1999]

4.51 If the deficit is greater than 10% of the PDF's total venture capital credits for the franking year, the debit is calculated in accordance with the following formula (the '130% formula'):

$$130\% \times \text{venture capital sub-account deficit} \times \frac{\text{company tax rate}}{1 - \text{company tax rate}}$$

[Subsection 5(2) of the New Business Tax System (Venture Capital Deficit Tax) Bill 1999]

4.52 The 130% formula incorporates an equivalent to FAT in relation to ordinary franking deficits. As with FAT, the additional 30% can be remitted in appropriate cases. ***[Subsection 160ASEN(2)]***

<u>Interaction between venture capital deficit tax and class C franking deficit tax</u>

4.53 Where both the PDF's venture capital sub-account and class C franking account are in deficit, the amount of the class C franking deficit tax in relation to the class C franking deficit is reduced. ***[Subsection 160AQJ(1C)]***

4.54 If the venture capital deficit tax is calculated using the 100% formula, the class C franking deficit tax is reduced by the amount of the venture capital deficit tax. This ensures the PDF does not pay deficit tax twice.

4.55 If the venture capital deficit tax is calculated using the 130% formula, the class C franking deficit tax will be reduced by the amount of venture capital deficit tax that would have been payable if it were calculated using the 100% formula. That is:

$$\begin{array}{l}\text{venture capital}\\ \text{sub-account deficit}\end{array} \times \frac{\text{company tax rate}}{1 - \text{company tax rate}}$$

4.56 This ensures that the extra 30% payable remains a penalty equivalent to FAT.

4.57 If the class C franking deficit tax is reduced to below zero, no class C franking deficit tax is payable, but no refund is available.

<u>Interaction between venture capital deficit tax and class C deficit deferral tax</u>

4.58 As noted in Step 3 at paragraph 4.47, refunds received within 6 months of the end of the franking year are used to calculate the venture capital deficit at the end of that year. These refunds may also have the effect of producing a class C franking deficit deferral tax liability.

4.59 To prevent the PDF from incurring 2 liabilities in relation to the one event, the amount of the deficit deferral tax is reduced. The amount of the reduction is the amount by which the refund or refunds created or increased the venture capital deficit less the amount to which the reduction has already been applied to reduce any class C franking deficit tax. ***[Subsection 160AQJC(2A)]***

Payments of venture capital deficit tax

4.60 When the PDF pays an amount of venture capital deficit tax it receives a class C franking credit. The credit arises on the day the payment is made. ***[Section 160APVI]***

4.61 The reason for allowing a franking credit is because the payment of venture capital deficit tax is effectively a payment of tax already imputed to the shareholder of the company by way of a class C franking credit. That imputation of tax resulted in a class C franking debit and it is necessary to recognise that debit by allowing a compensatory credit when the venture capital deficit tax is paid.

4.62 Where the venture capital deficit tax has been calculated using the 100% formula, the amount of the franking credit is the amount of the venture capital deficit tax paid. ***[Paragraph 160APVI(1)(a)]***

4.63 Where the venture capital deficits tax has been calculated using the 130% formula, the franking credit is:

$$\text{venture capital tax paid} \times \frac{100}{130}$$

[Paragraph 160APVI(1)(b)]

4.64 This preserves the 30% penalty equivalent to FAT.

4.65 The amount of franking credits otherwise available consequent on the payment of venture capital deficit tax is reduced by the class C franking deficit at the end of the year ***[subsection 160APVI(2)]***. This is because the class C franking debits that resulted in the deficit have already been effectively reinstated by the fact that deficits are not carried forward from one franking year to the next.

Example 4.3: Class C franking credit for the payment of venture capital deficit tax

On the last day of the franking year a PDF has a class C franking deficit tax liability of $100 and no venture capital deficit. The PDF receives a refund 2 months after the end of its franking year that creates a $50 venture capital deficit tax liability. The refund also creates a class C deficit deferral tax liability of $50.

The amount of the class C franking deficit tax is reduced by the amount of the venture capital deficit tax to $50.

The amount of the class C deficit deferral tax is not reduced as the amount of venture capital deficit tax that was referrable to the refund has already been offset against the class C franking deficit tax (see paragraph 4.59).

Credits to the venture capital sub-account

4.66 The PDF credits its venture capital sub-account in accordance with Table 4.2.

Table 4.2: Venture capital credits

Section	*Credit event*	*Time of the credit*	*Amount of the credit*
Subsections 160ASED(1) to (4)	A class C franking credit reasonably attributable to tax paid on a qualifying SME investment capital gain.	The day the class C franking account is credited with the corresponding franking credit.	The reasonably attributable amount of the class C franking credit.
Subsection 160ASED(4)	Election to defer reasonably attributable venture capital credits arising until the assessment day.	Assessment day.	The reasonably attributable amount of the class C franking credit as determined on the assessment day.
Section 160ASEE	Carry over surplus from previous franking year.	The beginning of the franking year.	The amount of the surplus immediately prior to the end of the previous franking year.
Section 160ASEF	Lapsing of estimated venture capital debit determination.	The termination time of the determination or the day a substituted debit determination is served on the PDF.	The amount of the determination.
Subsection 160ASEN(3)	Refund used in calculating venture capital deficit tax.	The day the refund is received.	The extent to which the refund created or increased the venture capital deficit.

Class C franking credits reasonably attributable to CGT on a qualifying SME investment

4.67 The venture capital credits which are reasonably attributable to class C franking credits arise either at the time the franking credit arises (upon payment of the tax) or on assessment ***[section 160ASED]***. Even though tax instalments paid for a year of income that give rise to class C franking credits may not be calculated by reference to the CGT liability for the year, it is nevertheless possible to impute a tax instalment to a CGT liability because the instalment may satisfy the total tax liability (including CGT) for the year. However, in order to do so, the attribution must be reasonable.

4.68 A venture capital credit arises at the time the class C franking credit arises (unless the PDF elects to have the credit arise on assessment). The amount of the credit is equal to the extent to which the class C franking credit may be reasonably attributed to the payment of tax by the PDF in relation to a qualifying SME investment capital gain (as defined at paragraphs 4.34 and 4.35). ***[Subsection 160ASED(1)]***

4.69 A payment of tax will not be reasonably attributable to a qualifying SME investment capital gain unless at the time the payment is made:

- the PDF has made a capital gain from a qualifying SME investment in the income year prior to the payment being made (or such a gain in the year is certain, e.g. because a forward contract has been entered into);
- there is no reason to suppose that the gain will be offset by carry forward losses or other capital losses;
- there is no reason to suppose that the PDF will not have an income tax liability upon assessment at least equal to the CGT on that gain; and
- a reasonable person with full information available to the PDF would consider the payment reasonably attributable to the tax on a qualifying SME investment capital gain.

4.70 Subsequent events that might make the attribution unreasonable do not affect the venture capital credit. However, an offsetting venture capital debit will arise at the end of the year to neutralise the credit (see paragraphs 4.94 to 4.98). ***[Section 160ASEH]***

4.71 However, rather than making an assessment at the time a tax instalment is paid as to whether it relates to a qualifying SME investment CGT liability or not, a PDF may prefer to wait until the end of the income year when its CGT liability will be certain. In which case, the PDF may elect to have venture capital credits arise on the assessment day. ***[Subsections 160ASED(3) and (4)]***

4.72 The assessment day is the earlier of:

- the day the PDF lodges its income tax return for the year (the usual case); or
- the day the Commissioner makes an assessment under section 166 of the ITAA 1936.

[Subsection 160ASED(5)]

4.73 The amount of the credit that arises at this time is equal to the extent to which class C franking credits for the year may be reasonably attributed on the assessment day to the payment of tax in relation to a qualifying SME investment capital gain. ***[Subsections 160ASED(1) and (4)]***

4.74 A payment of income tax will not be reasonably attributable to a qualifying SME investment capital gain unless at the time of assessment:

- the PDF has made a net capital gain from qualifying SME investments in the income year at least equal to that gain;
- the PDF has a SME assessable income liability in relation to the income year at least equal to the gain; and
- a reasonable person with full information available to the PDF would consider the tax paid reasonably attributable to a qualifying SME investment capital gain.

<u>Carry forward surplus</u>

4.75 When identifying the balance of the venture capital account, only venture capital credits and debits arising during the franking year are taken into account. Therefore, to ensure any venture capital surplus at the end of a franking year is not lost, a credit is provided at the commencement of the next franking year.

4.76 If at the end of the franking year the venture capital account is in surplus, a venture capital credit arises at the beginning of the next franking year equal to the amount of that surplus. ***[Section 160ASEE]***

<u>Debit determination</u>

4.77 If a PDF has a surplus in its venture capital sub-account at the time it declares a franked dividend it is required to venture capital frank the dividend to the maximum extent possible (see paragraphs 4.90 to 4.93). ***[Section 160ASEM]***

4.78 To allow the PDF to take into account an anticipated debit, it may make a venture capital debit determination in certain circumstances, which will produce a debit to its venture capital sub-account before the actual debit arises ***[sections 160ASEI and 160ASEK].*** This operates in the same way that franking debits arise for estimated debit determinations.

4.79 The venture capital debit produced by a debit determination is no longer required after the termination time of the determination or when the determination is replaced by a subsequent determination. Therefore, to offset the debit applied to the venture capital account, a corresponding credit is produced on the day:

- of the termination time of the determination ***[subsection 160ASEF(1)]***; or
- a notice of a debit determination that is in substitution for an earlier debit determination is served on the taxpayer ***[subsection 160ASEF(2)].***

<u>Refund used in calculating venture capital deficit tax</u>

4.80 Venture capital deficit tax is calculated taking into account certain refunds received in the following franking year. This method of calculating the venture capital deficit tax incorporates an equivalent to deficit deferral tax.

4.81 Notionally including a debit that is actually received in one franking year in the prior franking year may potentially lead to the PDF incurring 2 debits in relation to the one refund.

4.82 To prevent this outcome a credit arises when a refund that is received within 6 months after the end of the franking year creates or increases the venture capital deficit tax. This is equivalent to the franking credit that arises under current section 160APMAB in relation to deficit deferral tax. ***[Subsection 160ASEN(3)]***

4.83 The time the credit arises is the time the refund is received. The amount of the credit is the amount by which the refund created or increased the venture capital deficit tax.

Example 4.4: Calculating the venture capital credit for a refund that produces or increases a venture capital deficit tax

> On the last day of the franking year a PDF has neither a class C franking deficit nor a venture capital deficit.
>
> Within 6 months of the end of that year the PDF receives a refund that creates a $50 venture capital deficit tax liability and a $50 class C deficit deferral tax liability.
>
> The refund produces a $50 increase in venture capital deficit tax. Consequently, when the refund is received, a $50 venture capital credit arises.

Debits to the venture capital sub-account

4.84 The PDF debits its venture capital franking account in accordance with Table 4.3.

Table 4.3: Venture capital debits

Section	***Debit event***	***Time of the debit***	***Amount of the debit***
Subsections 160ASED(6) to (9)	Class C franking debit that is reasonably attributable to a reduction amount in relation to a venture capital credit.	The time that the class C franking account is debited with the corresponding franking debit (unless the venture capital credit to which the debit relates arises on the assessment day).	The reasonably attributable amount of the class C franking debit.
Section 160ASEH	Amount previously attributed exceeds the limit for the year.	The last day of the relevant income year.	The amount by which the previously attributed amounts exceed the limit.
Section 160ASEG	Declaration of venture capital franked dividend.	The day the declaration is made.	Venture capital franked amount of the dividend.
Section 160ASEI	Estimated venture capital debit determination.	The day notice of the debit determination is served on the PDF.	The amount specified in the notice.
Subsection 160ASEM(2)	Failure to empty sub-account.	The day the venture capital dividend is paid.	The lesser of: • the surplus in the sub-account at that time; and • the extent to which the dividend is class C franked, but not venture capital franked.

Section	*Debit event*	*Time of the debit*	*Amount of the debit*
Sections 160ASEJ and 160AQCBA	Streaming venture capital rebate benefits.	The day notice of determination under section 160AQCBA is served in writing on the PDF.	As calculated under paragraph 160AQCBA (8)(b).

Reasonably attributable to reduction amount

4.85 A venture capital debit generally arises at the time of a class C franking debit to the extent that the class C franking debit is reasonably attributable to a reduction amount in relation to a venture capital credit. However, if the PDF made an election to defer the relevant venture capital credit until the assessment day, and the debit would otherwise arise before that day, then the debit arises at the same time as the credit. ***[Subsection 160ASED(6)]***

4.86 A reduction amount in relation to a venture capital credit is effectively an amount of tax which gave rise to a venture capital credit which is subsequently refunded. ***[Subsection 160ASED(7)]***

4.87 The events which produce reduction amounts are:

- the refund of a payment of tax;
- the crediting of an income tax instalment or refund against a tax liability that does not produce a franking credit (e.g. fringe benefits tax); and
- the serving of an amended company tax assessment reducing the company tax of the PDF.

Declaration of venture capital franked dividend

4.88 A PDF imputes venture capital credits to its shareholders when it pays a venture capital franked dividend. To reflect this in the venture capital sub-account, the account will be debited by the venture capital franked amount of the dividend. ***[Section 160ASEG]***

4.89 The debit arises at the time the declaration is made.

Failure to empty sub-account

4.90 The PDF is required to reduce its venture capital sub-account when it pays a class C franked dividend under a resolution to all shareholders if it has a surplus in its venture capital sub-account immediately before the declaration. ***[Section 160ASEM]***

4.91 The amount by which the sub-account must be reduced is the lesser of:

- the balance of its venture capital sub-account immediately before the dividend is declared ***[paragraph 160ASEM(1)(e)]***; and
- the class C franked amount of the dividend ***[paragraph 160ASEM(1)(d)]***.

4.92 This measure is to prevent the PDF from accumulating venture capital credits until a time when it has shareholders better able to benefit from the credits.

4.93 If the PDF fails to comply with this requirement, the venture capital sub-account will be debited ***[subsection 160ASEM(2)]***. The amount of the debit is the lesser of:

- the remaining surplus in the sub-account; and
- the amount to which the dividend was class C franked but not venture capital franked.

Limit on venture capital credits for the franking year

4.94 There is a limit on the net amount of venture capital credits that may arise in an income year which relate to tax for that year. For these purposes, the net amount of venture capital credits which relate to tax for a year of income is the total of venture capital credits relating to tax paid on taxable income for the year (whether paid during the year or after the end of the year) reduced by any venture capital debits attributable to that tax (e.g. because it is refunded) ***[subsection 160ASEH(2)]***. This limit is necessary to ensure that the credits that arise during the year that are reasonably attributable to the payment of tax in relation to a qualifying SME investment are also reasonably attributable at the end of the year. ***[Section 160ASEH]***

4.95 A venture capital debit arises to the extent that the net amount of venture capital credits that have arisen during the year is not reasonably attributable to the payment of tax in relation to a qualifying SME investment capital gain.

4.96 The debit arises on the last day of the income year.

4.97 The amount of the debit is the net amount of venture capital credits in relation to tax for the income year reduced by the lesser of:

- the adjusted amount of notional tax payable on capital gains from qualifying SME investments (i.e. the maximum value of franking credits obtainable from CGT paid by the PDF on relevant capital gains of the PDF); and

- the adjusted amount of tax paid (after allowing credits and rebates) by the PDF on taxable income from SME investments (i.e. the maximum value of franking credits obtainable from total tax paid by the PDF on relevant taxable income).

4.98 The amount of notional tax payable on capital gains from qualifying SME investments is:

$$\frac{\text{total qualifying SME investment capital gains}}{\text{total SME investment capital gains}} \times \text{assessable income from capital gains on SME investments} \times \text{SME tax rate}$$

Where:

- ***total qualifying SME investment capital gains*** are all qualifying venture capital gains made during the income year;
- ***total SME investment capital gains*** are all capital gains made during the year on all investments excluding unregulated investments;
- ***assessable income from capital gains on SME investments*** is the amount of assessable income made by the PDF in the income year from capital gains on SME investments; and
- ***SME tax rate*** is the current rate of tax a PDF must pay on its SME income (currently 15%).

Example 4.5: Calculating the limit on venture capital credits for the income year

Throughout the course of the franking year a PDF received $250 of venture capital credits.

Assume a SME tax rate of 15% and a company tax rate of 30%.

At the end of the year, the PDF has the following income:

qualifying SME investment capital gains	$1,000
total SME investment capital gains	$1,000
assessable income from capital gains on SME investment	$800

After deductions, the PDF has a SME taxable income of $700, and the tax liability (at 15%) of $105 is paid in full.

The notional tax payable on capital gains from qualifying SME investments is:

$$\frac{\$1{,}000}{\$1{,}000} \times \$800 \times 15\% = \$120$$

The adjusted amount is:

$$\$120 \times \frac{70\%}{30\%} = \$280$$

The tax paid by the PDF on taxable income from SME investments is $105.

The adjusted amount is:

$$\$105 \times \frac{70\%}{30\%} = \$245$$

A debit will be posted to the PDF's venture capital account on the last day of the income year equal to:

$$\$250 - \$245 = \$5$$

Note that the debit is calculated using the adjusted amount of tax paid by the PDF on taxable income from SME investment as it is lower than the adjusted amount of the notional tax payable on capital gains from qualifying SME investments.

Estimated venture capital debit determination

4.99 The requirement to distribute venture capital credits to reduce the venture capital sub-account when paying certain dividends may result in the sub-account going into deficit. This is demonstrated in Example 4.6.

Example 4.6: Circumstances in which an estimated venture capital debit determination is required

A PDF is expecting a $36 refund of tax paid that will produce a $64 debit to the sub-account and it wants to pay a $64 fully franked dividend under a resolution to all its shareholders.

If the PDF has a $64 surplus in its sub-account when it declares the dividend it would have to venture capital frank it to $64 or a penalty debit will be applied to the account to reduce the balance (in these circumstances to zero). However, when the refund is received it will incur a $64 venture capital debit putting the account into deficit of $64.

4.100 To avoid forcing PDFs into deficit in situations like this, under certain circumstances the PDF may obtain an estimated venture capital debit determination from the Commissioner. The debit determination produces a venture capital debit. ***[Section 160ASEI]***

4.101 In Example 4.6, if the PDF obtained a debit determination before declaring the dividend, the balance of its sub-account would be reduced to zero and the sub-account would not ultimately be forced into deficit.

Streaming venture capital rebate benefits

4.102 The anti-streaming rules that operate to prevent companies from streaming dividends to their shareholders will also apply to the streaming of benefits from venture capital rebates by a PDF.

4.103 If a PDF does stream benefits from venture capital rebates and the Commissioner makes a determination under paragraph 160AQCBA(3)(a) of the ITAA 1936, it will receive a class C franking debit and a venture capital debit. ***[Sections 160AQCBA and 160ASEJ]***

4.104 The amount of each debit is the same and is calculated in accordance with paragraph 160AQCBA(8)(b) of the ITAA 1936.

4.105 Alternatively, the Commissioner may make a determination under paragraph 160AQCBA(3)(b) of the ITAA 1936 that no venture capital franking rebate arises for the recipient of the streamed benefit.

How does a PDF pay a venture capital franked dividend?

4.106 A PDF may only venture capital frank certain dividends. Dividends that may be venture capital franked (eligible dividends) are dividends that are:

- class C franked;
- paid under a resolution under which;
  - the dividends are to be paid to all shareholders; and
  - the amount of the dividend per share is the same.

This requirement is necessary to limit opportunities for a PDF to stream venture capital franking benefits to their eligible shareholders. ***[Subsection 160ASEL(1)]***

4.107 To frank one of these dividends the PDF must make a venture capital franking declaration. The declaration has to be made in the class C franking declaration and must provide that each dividend paid under the resolution is venture capital franked to the same extent. ***[Subsection 160ASEL(2)]***

4.108 The extent to which the PDF may venture capital frank the dividend is limited to the extent the dividend is class C franked. ***[Subsection 160ASEL(4)]***

Example 4.7: Calculating the venture capital franked amount of a dividend

A PDF pays a $100 dividend that is 50% class C franked and in the declaration purports to 60% venture capital frank it. The extent to which the dividend is venture capital franked is:

$$\$100 \times 50\% = \$50$$

Application and transitional provisions

4.109 The amendments apply to venture capital gains of PDFs derived after the Capital Gains Tax Bill receives Royal Assent.

Consequential amendments

4.110 There are no consequential amendments relating to these measures other than those described in this Chapter.

Chapter 5
Low-value pools

Outline of Chapter

5.1 This Chapter explains amendments made to the income tax law that will:

- remove the immediate deduction for plant costing $300 or less;
- provide an option for plant costing less than $1,000 to be pooled;
- provide an option for plant that has been depreciated to less than $1,000 under the diminishing value method to be pooled; and
- allow the pooled plant to be depreciated over an effective life of 4 years using the diminishing value method.

5.2 These measures will not apply to small business taxpayers. ***[Schedule 6 to this Bill]***

Context of Reform

5.3 Division 42 of the ITAA 1997 (depreciation of plant) currently permits a taxpayer an immediate deduction for an item of plant costing $300 or less. This immediate deduction is to be replaced with a system that allows taxpayers, except small business taxpayers, an option to depreciate all items of plant costing less than $1,000 through a pooling mechanism. Providing such a mechanism will reduce compliance costs for taxpayers.

5.4 Maintaining the immediate deduction for plant costing $300 or less for small business taxpayers is an interim measure pending the introduction of a Simplified Tax System for these taxpayers, with effect from 1 July 2001.

5.5 Taxpayers using the diminishing value method have to calculate their deduction based on an ever declining depreciable balance of the plant. This requires an ascertainment of this balance every year. Providing a pooling mechanism for these items when that balance is less than $1,000 will simplify the calculation process.

Summary of new law

5.6 The new law will replace the immediate deduction for plant costing $300 or less that is acquired on or after 1 July 2000. Instead, there will be an option to pool all plant costing less than $1,000. These items will then be depreciated over an effective life of 4 years using the diminishing value method. Where this option is not exercised, the depreciation rate for the plant will be determined only by its effective life, similar to other depreciable plant. The immediate deduction is to be retained for plant acquired by small business taxpayers.

5.7 The new law will also give taxpayers an option to pool plant that has been depreciated to less than $1,000 under the diminishing value method. These items will then be depreciated over an effective life of 4 years using that method. This option will be available on an item by item basis and from the commencement of the 2000-2001 income year. This option will not be available to small business taxpayers.

Comparison of key features of new law and current law

New law	*Current law*
All items of plant costing less than $1,000 may be pooled and depreciated over an effective life of 4 years using the diminishing value method.	There is an immediate deduction for items of plant costing $300 or less.
Any items of plant which have been depreciated under the diminishing value method to less than $1,000 may be pooled and depreciated over an effective life of 4 years using that method.	The current law has no equivalent provision.

Detailed explanation of new law

Removing the immediate deduction

5.8 Proposed section 42-167 in the Capital Allowances Bill will permit an immediate deduction for an item of plant costing $300 or less.

5.9 This Bill amends that proposed section so that the immediate deduction will not apply to plant:

- acquired under a contract;
- commenced to be constructed; or
- acquired in some other way,

on or after 1 July 2000. ***[Item 6, subsection 42-167(1)]***

5.10 However, the immediate deduction for plant will continue to be available to small business taxpayers. The rules that set out who qualifies as a small business taxpayer are contained in proposed Subdivision 960-Q in the Capital Allowances Bill. ***[Item 6, subsection 42-167(2)]***

Low-value pools

5.11 New Subdivision 42-M is to be inserted into the ITAA 1997 to allow a depreciation deduction for certain plant through a pool ***[item 7, Subdivision 42-M]***. This pool is to be defined as a ***low-value pool***. It will include plant costing less than $1,000 and plant that has been depreciated below $1,000 under the diminishing value method.

5.12 A low-value pool is created in the first income year in which there is an allocation of plant to it. ***[Item 7, section 42-450 and item 10]***

Option to pool plant costing less than $1,000

5.13 Taxpayers can choose to allocate an item of low-cost plant to the low-value pool in the income year they acquire it ***[item 7, subsection 42-455(1)]***. An item of ***low-cost plant*** is plant costing less than $1,000 ***[item 7, subsection 42-455(2) and item 9]***. The $1,000 threshold is to be determined on an item by item basis.

5.14 Once a choice is made to allocate low-cost plant to this pool, all low-cost plant acquired in that income year and subsequent years must be allocated and remain allocated to the pool ***[item 7, subsections 42-460(1) and (3)]***. Plant allocated to the pool will then be depreciated over an effective life of 4 years using the diminishing value method.

5.15 This choice will be available from 1 July 2000.

5.16 However, the choice will not be available to small business taxpayers. Instead, these taxpayers will generally be entitled to accelerated depreciation rates on that low-cost plant. These taxpayers will retain the immediate deduction where the cost is $300 or less. ***[Item 7, subsection 42-460(2)]***

5.17 The choice to allocate low-cost plant to a low-value pool will also not be available where plant costing $300 or less is acquired before 1 July 2000 ***[item 7, subsection 42-460(4)]***. This ensures taxpayers, with a substituted accounting period that ends after 30 June 2000, will not be able to avail themselves of both the immediate deduction and the deduction through the low-value pool for this plant.

5.18 This choice will also not be available where plant has already been allocated to a pool under the existing pooling provisions contained in Subdivision 42-L. These provisions allow taxpayers to pool items of plant which have the same depreciation rates. ***[Item 7, subsection 42-460(5)]***

5.19 Taxpayers who do not choose to allocate low-cost plant to the low-value pool must depreciate that plant according to its effective life.

Option to pool plant that has been depreciated to less than $1,000 under the diminishing value method

5.20 A taxpayer can also choose to allocate an item of plant to the same pool mentioned above where:

- the plant's undeducted cost at the beginning of the income year is less than $1,000; and
- the plant's depreciation deductions have been calculated using the diminishing value method.

[Item 7, subsection 42-455(3)]

5.21 Once an item is allocated it must remain in the low-value pool ***[item 7, subsection 42-460(3)]***. However, unlike the choice for low-cost plant, this choice can be made on a item by item basis. The availability of this choice on an item by item basis ensures that plant with an effective life of less than 4 years can continue to be depreciated in the usual way.

5.22 This choice will also not be available where plant has already been allocated to a pool under the existing pooling provisions contained in Subdivision 42-L. ***[Item 7, subsection 42-460(5)]***

5.23 The option to allocate this plant to a low-value pool will be available from the beginning of the 2000-2001 income year. It will allow plant with a diminishing value balance of less than $1,000 to be pooled with low-cost plant and depreciated over an effective life of 4 years using the diminishing value method.

Private or exempt use of pooled plant

5.24 Taxpayers who allocate plant to the low-value pool are required to make an estimate of any future non-income producing use of the plant. Where there is to be some non-income producing use, the cost or undeducted cost of the plant allocated to the pool is reduced by the percentage that represents that use. ***[Item 7, section 42-465]***

Example 5.1

Fred acquired a computer that costs $800 after 1 July 2000 and chose to allocate it to a pool. He estimated that 40% of the use of the computer would be for non-income producing purpose and 60% for income producing purposes.

The amount that is allocated to the pool is $480 ($800 × 60%).

Depreciation deductions for pooled plant

5.25 The depreciation deductions for plant allocated to the pool is the sum of 2 amounts. The first amount is 18.75% of the total costs of low-cost plant allocated to the pool during the income year ***[item 7, paragraph 42-470(1)(a)]***. This rate represents half of 37.5% which is the diminishing value rate based on an effective life of 4 years. Halving the rate is in recognition of plant being allocated to the pool throughout the income year.

5.26 The second amount is 37.5% of both the pool closing balance for the previous income year and the total of the undeducted costs of plant, other than low-cost plant, allocated to the pool during the year of income ***[item 7, paragraph 42-470(1)(b)]***. This plant is that which has been depreciated under the diminishing value method to less than $1,000.

Example 5.2

ABC Co's pool closing balance for the year ended 30 June 2001 is $1,200. During the 2001-2002 income year ABC Co acquired an item of plant for $400. ABC Co also chose to allocate to the pool an item of plant which has an undeducted cost of $900.

The depreciation deductions are calculated as follows:

Low-cost plant:	$400 × 18.75% =	$75
Pool closing balance from previous year ($1,200) and depreciated plant allocated to the pool ($900):	$2,100 × 37.5% =	<u>$788</u>
Total depreciation deduction:		<u>$863</u>

5.27 The ***pool closing balance*** for a particular income year is the pool's closing balance for the previous income year *plus* the total costs or undeducted costs, as the case may be, of plant allocated to the pool *less* the depreciation deductions for the pooled plant. ***[Item 7, subsection 42-470(2) and item 11]***

Example 5.3

Assuming the facts in Example 5.2, the pool closing balance at the end of the 2001-2002 income year will be:

$1,200 + ($400 + $900) – $863 = $1,637

Disposal of pooled plant

5.28 Where there is a disposal of plant allocated to the pool, any disposal proceeds are to be used to reduce the pool closing balance ***[item 7, subsection 42-475(1)]***. However, where on allocation of plant to a pool, there has been an estimate of some non-income producing use of that plant, the disposal proceeds are to be reduced by the percentage represented by that use, before any reduction in the pool closing balance ***[item 7, subsection 42-475(2)]***.

Example 5.4

> Fred sold the computer referred to in Example 5.1 for $400. The pool closing balance would be reduced by $240 ($400 × 60%).

5.29 If the sum of the proceeds from disposal of plant in the low-value pool exceeds the closing balance of the pool, the excess is to be included in assessable income. ***[Item 7, subsection 42-475(3)]***

5.30 The reduction of the low-value pool for disposals of plant has 2 consequences. First, the plant that is disposed of effectively attracts a full year's depreciation in the income year of disposal. Second, there is a lesser amount available for depreciation of the plant allocated to the pool in the following income years. This is the equivalent of including an amount in assessable income.

Application and transitional provisions

5.31 The amendments in this Schedule apply to low-cost plant for assessments for the income year in which 1 July 2000 occurs. The amendments, to the extent they apply to plant allocated to a pool where the undeducted cost is less than $1,000, apply for the 2000-2001 income year and later income years. ***[Item 15]***

Consequential amendments

5.32 This Bill makes consequential amendments to the ITAA 1997 and the ITAA 1936 to recognise the introduction of these new pooling arrangements. ***[Items 1 to 5, 8 and 12 to 14]***

Chapter 6
Regulation impact statement

Policy objective

The objectives of the New *Business* Tax System

6.1 The measures in these Bills are a part of the Government's broad ranging reforms which will give Australia a New *Business* Tax System. Those reforms are based on the Recommendations of the Review, established by the Government to consider reform of Australia's business tax system.

6.2 The Government established the Review in August 1998 to consult on its plan to comprehensively reform the business tax system (outlined in ANTS). The Review made 280 recommendations to the Government that were designed to achieve a more simple, stable and durable business tax system.

6.3 The New *Business* Tax System is designed to provide Australia with an internationally competitive business tax system that will create the environment for achieving higher economic growth, more jobs and improved savings, as well as a sustainable revenue base so that the Government can continue to deliver services to the community.

6.4 The New *Business* Tax System also seeks to provide a basis for more robust investment decisions by:

- improving simplicity and transparency;
- reducing the cost of compliance; and
- providing fairer, more equitable outcomes.

6.5 The Bills dealt with in this Explanatory Memorandum are the third phase of legislation to implement the New *Business* Tax System. The earlier phases involved the following Bills, passed by the Senate on 29 November 1999:

- the New Business Tax System (Integrity and Other Measures) Bill 1999;
- the New Business Tax System (Capital Allowances) Bill 1999;

- the New Business Tax System (Income Tax Rates) Bill (No. 1) 1999;
- the New Business Tax System (Former Subsidiary Tax Imposition) Bill 1999;
- the New Business Tax System (Capital Gains Tax) Bill 1999; and
- the New Business Tax System (Income Tax Rates) Bill (No. 2) 1999.

The objectives of measures in these Bills

6.6 The New *Business* Tax System will enhance Australia's competitiveness through lower company and capital gains tax rates, and reduced compliance costs.

6.7 The measures contained in the New Business Tax System (Miscellaneous) Bill 1999 have these objectives:

- Ensuring that company profits paid as dividends to resident shareholders will always be taxed at the shareholder's marginal tax rate. This will be fairer to self-funded retirees and other low income earners and will remove investment distortions for super funds;
- Responding to avoidance arrangements that exploit the availability of the rebate on unfranked intercorporate dividends. Ensuring a consistent treatment of all resident companies receiving unfranked dividends. Reducing the need for complex anti-avoidance provisions;
- Simplifying depreciation calculations and record keeping for taxpayers with depreciable plant;
- Changing the calculation of imputation credits, converting franking account balances and changing the infrastructure borrowings rebate to reflect the reduction in the company tax rate provided for by the Income Tax Rates Bill No. 1;
- Promoting venture capital investments by further encouraging Australian super funds and similar entities to invest in PDFs. The Review argued that venture capital funding, both from domestic and non-resident sources, should be stimulated[1]. The Government accepted the Review's recommendation to grant an exemption for venture capital investments by non-resident

[1] *A Tax System Redesigned*, page 611.

tax-exempt pension funds. The Government also decided that there was also a need to encourage venture capital investment by domestic super funds and similar entities. This will boost funding for emerging enterprises, facilitate growth in knowledge-based jobs and contribute to the retirement income of all Australians.

6.8 This Explanatory Memorandum also explains the New Business Tax System (Venture Capital Deficit Tax) Bill 1999 which is part of the legislative scheme to effect the objective of promoting venture capital investments.

Implementation options

6.9 Most of the measures in these Bills arise from recommendations of the Review. Those Recommendations were the subject of extensive consultation. The implementation options for those measures can be found in *A Platform for Consultation* (APFC) and *A Tax System Redesigned* (ATSR). Table 6.1 shows where the measures (or the principles underlying them) are discussed in those publications.

Table 6.1: Options for implementing measures in these Bills arising from the Recommendations

Measure	*APFC*	*ATSR*
Making imputation credits (franking rebates), that are attached to dividends paid to Australian resident individuals or complying super funds and similar entities after 30 June 2000, refundable to the extent that they exceed tax payable	Chapter 15, pp. 348-349; 360-366.	Recommendation 11.7, pp. 421-424.
Removing the intercorporate dividend rebate on unfranked dividends paid after 30 June 2000, except within company groups, while allowing a deduction to an Australian resident company that is paid such a dividend (except portfolio dividends) after 30 June 2000 and on-pays it to a non-resident parent.	Chapter 15, pp. 349-355, 356; Chapter 17, pp. 389-399.	Recommendations 11.1 and 11.2, pp. 411-414.

Measure	*APFC*	*ATSR*
Replacing immediate deductibility for plant costing $300 or less with a right to pool plant costing less than $1,000 and to depreciate that pool, as a single item of plant, over an effective life of 4 years. Allow taxpayers to add plant to that pool if it was written down to less than $1,000 under the diminishing value method.	Chapter 1, pp. 95-96.	Recommendation 8.10, pp. 316-318.
Effectively making capital gains on venture capital investments by pooled development funds exempt from tax, if they are distributed to a super fund or similar entity, by allowing an imputation credit for the distributions, even though those distributions are exempt from tax.	Not discussed in APFC.	Not discussed in ATSR.

6.10 The changes to the imputation system and the infrastructure borrowings rebate are consequential amendments because of the reduction in the company tax rate.

Assessment of impacts

6.11 The potential compliance, administrative and economic impacts of the measures in these Bills have been carefully considered, both by the Review and by the business sector. The Review focused on the economy as a whole in assessing the impacts of its recommendations and concluded that there would be net gains to business, government and the community generally from business tax reform.

Impact group identification

6.12 The measures in these Bills specifically impact on those taxpayers identified in Table 6.2.

Table 6.2: Taxpayers affected by the measures in these Bills

Measure	*Affected taxpayers*
Making excess imputation credits refundable.	Shareholders who are individuals, superannuation funds, approved deposit funds, life insurance companies, registered organisations, pooled superannuation trusts and certain other trustees, provided they have imputation credits in excess of their income tax liability.
Removing the intercorporate dividend rebate on unfranked dividends. Allowing a deduction when they are on-paid to non-resident parent entities.	Public companies receiving unfranked dividends. Companies that on-pay the dividend to foreign parents.
Replacing the immediate deduction for \$300 plant with a pooling scheme for plant costing less than \$1,000.	Taxpayers (except small business taxpayers) who acquire plant.
Allow plant written down to less than \$1,000 under the diminishing value method to come within that pooling scheme.	Taxpayers (except small business taxpayers) who have plant written-down under the diminishing value method to less than \$1,000.
Consequential changes to the infrastructure borrowings rebate and the imputation system because of the company tax rate reduction.	Investors in the infrastructure borrowings scheme and shareholders.
Allowing pooled development funds to effectively provide super funds and similar entities with tax-free venture capital gains.	Complying super funds and similar entities who invest in pooled development funds.

Analysis of costs / benefits

Compliance costs

6.13 The compliance cost effects of these Bills are:

- refunding excess imputation credits will not have a compliance cost for most taxpayers because data which is already provided will be used to calculate the refund. Taxpayers who currently do not lodge a tax return[2] will need to in order to claim their imputation credit refund;

[2] These are determined by the Commissioner in a notice in the *Commonwealth Gazette*. Broadly, those who must lodge usually have taxable incomes above \$5,400, have had tax deducted from receipts, are subject to provisional tax or are carrying on a business.

- removing the intercorporate dividend rebate on unfranked dividends will decrease compliance costs for companies eligible for the rebate now because they will no longer have to calculate the rebate. There will also be a reduction in compliance costs for companies that currently have to decide if they are a private or public company, to know if they are eligible for the rebate. This can be difficult as their status for tax law purposes is not necessarily the same as it is for company law;

- providing a deduction when an Australian company on-pays unfranked non-portfolio dividends to an overseas parent may result in a small increase in compliance costs from having to track the receipt of the unfranked dividend into the dividend paid to the parent;

- pooling low-cost plant (i.e. costing under $1,000) and low-value plant (i.e. plant depreciated below $1,000 under the diminishing value method) into a notional single item of plant will significantly reduce compliance costs for those taxpayers who opt to use that system. In particular, the record keeping involved in tracking separate items of low-cost, or low-value, plant will be greatly reduced;

- changing the calculation of imputation credits, and converting the balance in companies' franking accounts, to reflect the reduced company tax rate will cause a small, one-off compliance cost for most companies arising from implementing changes to their systems;

- changing the rate of the infrastructure borrowings rebate will have no effect on compliance costs because the measure requires only changing a 36% rebate to a 34% rebate and then to a 30% rebate;

- where a PDF provides superannuation funds and similar entities with tax-free capital gains on venture capital investments, there may be some increase in compliance costs; and

- there will be no specific compliance costs involved with the New Business Tax System (Venture Capital Deficit Tax) Bill 1999.

Administration costs

6.14 The refundability of excess imputation credits from 1 July 2000 will have some impact on administration costs. This is because additional tax returns are expected to be lodged, so that refunds can be claimed. The other measures in this Bill are not expected to impose significant ongoing administration costs.

Government revenue

6.15 The revenue impact of each measure is noted in the General Outline for this Explanatory Memorandum.

Economic benefits

6.16 The New *Business* Tax System will provide Australia with an internationally competitive business tax system that will create the environment for achieving higher economic growth, more jobs and improved savings. The economic benefits of these measures are explained in more detail in the publications of the Review, particularly *A Platform for Consultation* and *A Tax System Redesigned.*

Other issues – consultation

6.17 The consultation process began with the release of ANTS in August 1998. The Government established the Review in that month. Since then, the Review has published 4 documents about business tax reform; in particular *A Platform for Consultation* and *A Tax System Redesigned* in which it canvassed options, discussed issues and sought public input.

6.18 Throughout that period, the Review held numerous public seminars and focus group meetings with key stakeholders in the tax system. It received and analysed 376 submissions from the public about reform options. Further details are contained in paragraphs 11 to 16 of the Overview to *A Tax System Redesigned.*

6.19 In analysing options, the published documents frequently referred to, and were guided by, views expressed during the consultation process.

Conclusion and recommended option

6.20 The measures in these Bills should be adopted to support a more efficient, innovative and internationally competitive Australian business sector, to reduce compliance costs and to establish a simpler and more structurally sound business tax system.