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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

NEW BUSINESS TAX SYSTEM (INCOME TAX RATES) BILL (No. 1) 1999

EXPLANATORY MEMORANDUM

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

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General outline and financial impact

Cutting the company tax rate

This Bill amends the *Income Tax Rates Act 1986* to reduce the company tax rate:

- to 34% from 36% for the 2000-2001 year of income; and
- to 30% from 34% for the 2001-2002 and later years of income.

Date of effect: The amendments giving effect to the 34% rate apply to assessments for the 2000-2001 year of income. The amendments giving effect to the 30% rate apply to assessments for the 2001-2002 and later years of income.

Proposal announced: The proposal was announced in Treasurer's Press Release No. 58 of 21 September 1999 (in particular, refer to Attachment A of that Press Release).

Financial impact: The following table sets out the financial impact of the reduction in the company tax rate:

1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
-\$60m	-\$1260m	-\$3480m	-\$3135m	-\$3090m	-\$3405m

Compliance cost impact: Negligible.

Chapter 1

Cutting the company tax rate

Outline of Chapter

1.1 This Chapter explains the amendments made by the New Business Tax System (Income Tax Rates) Bill (No. 1) 1999 (this Bill) to reduce the company tax rate:

- to 34% from 36% for the 2000-2001 year of income [*Schedule 1 to this Bill*]; and
- to 30% from 34% for the 2001-2002 and later years of income [*Schedule 2 to this Bill*].

Context of Reform

1.2 The reductions in the company tax rate provided for in this Bill are a key component of the New *Business Tax System* announced in Treasurer's Press Release No. 58 of 21 September 1999.

1.3 The basis of the New *Business Tax System* is the *Review of Business Taxation: A Tax System Redesigned* (the Review). The Review arose as a consequence of the release of the Government's Tax Reform Document: *Tax Reform: not a new tax, a new tax system* (ANTS) in August 1998.

1.4 The ANTS document contemplated the company tax rate being reduced to 30%. In turn, the phased reduction in the company tax rate provided for in this Bill is in line with the recommendations of the Review.

1.5 The changes proposed by this Bill provide Australia with an internationally competitive company tax rate. The 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.

1.6 The Review also recommends taxing various entities on the same basis as companies (also known as *consistent entity treatment*). An implication of taxing an entity on the same basis as a company is that the tax rate applying to companies should also apply to that entity.

1.7 However, the proposed amendments in this Bill only change the tax rate for entities that have a rate which is currently pegged to the company tax rate. Amendments to tax rates for entities that are to be subject to consistent entity treatment will be introduced at the same time as amendments are introduced to provide for that treatment.

Summary of new law

1.8 The new law will provide for a 34% company tax rate for the 2000-2001 year of income. This rate will also apply to all other existing income tax rates that are pegged to the company tax rate (e.g. the rate applying to corporate unit trusts and public trading trusts).

1.9 The 34% rate is a transitional rate that will only apply for the 2000-2001 year of income. For the 2001-2002 and later years of income, the new law will provide for a 30% company tax rate. Like the 34% rate, the 30% rate will also apply to other existing income tax rates that are pegged to the company tax rate.

Comparison of key features of new law and current law

Table 1.1

<i>New Law</i>	<i>Current Law</i>
The company tax rate, and other rates set out in the <i>Income Tax Rates Act 1986</i> (ITRA 1986) that are pegged to the company tax rate, will be: <ul style="list-style-type: none">• 34% for the 2000-2001 year of income; and• 30% for the 2001-2002 and later years of income.	The company tax rate, and other rates set out in the ITRA 1986 that are pegged to the company tax rate, are 36%.

Detailed explanation of new law

Amendments for the 34% company tax rate

1.10 Schedule 1 to this Bill contains the proposed amendments to the ITRA 1986 to give effect to the 34% company tax rate for the 2000-2001 year of income.

The rate change for companies generally

1.11 The general company tax rate in respect of taxable income is provided for in subsection 23(2) of the ITRA 1986. This Bill proposes to

amend this provision to give effect to the proposed rate of 34% for the 2000-2001 year of income. [Schedule 1, item 1]

Changes to rates pegged to general company tax rate

1.12 The bulk of the other amendments in Schedule 1 propose to change rates, applying to various entities, that are intended to reflect the underlying general company tax rate [Schedule 1, items 2 to 6 and 9 to 11].

Table 1.2 outlines the nature of each of these changes:

Table 1.2: Amendments to rates that are identical to the company tax rate

<i>This item of Schedule 1...</i>	<i>Amends this provision of the ITRA 86...</i>	<i>Which provides...</i>	<i>For this entity...</i>
2	Paragraph 23(3)(a)	The rate in respect of taxable income.	A private company that is neither a life insurance company, nor a pooled development fund (PDF) at the end of the year of income.
3	Paragraph 23(4)(bb)	The rate in respect of the RSA category B component of the RSA combined component of taxable income.	A company that is a registered organisation (i.e. a non-profit friendly society, a trade union or another organisation of employees under the <i>Industrial Relations Act 1988</i>).
4	Subparagraph 23(4A)(c)(ii)	The rate in respect of the standard component of the general fund component of taxable income.	A life insurance company that is not a mutual life insurance company at the end of year of income.
5	Paragraph 23(4BA)(b)	The rate in respect of the standard component of taxable income.	A company that is a retirement savings account (RSA) provider, but is not a life insurance company or a registered organisation.

<i>This item of Schedule 1...</i>	<i>Amends this provision of the ITRA 86...</i>	<i>Which provides...</i>	<i>For this entity...</i>
6	Paragraph 23(4C)(c)	The rate in respect of the amount of taxable income exceeding the PDF component.	A company that becomes a PDF during the year of income and still is at the end of the year of income.
9	Section 24	The rate in respect of net income.	The trustee of a corporate unit trust.
10	Section 25	The rate in respect of net income.	The trustee of a public trading trust.
11	Section 28	The rate in respect of a share of net income of a trust estate determined under subsection 98(3) of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936).	The trustee of the trust estate, who is liable to be assessed and pay tax on behalf of a non-resident corporate beneficiary under that subsection.

Change for non-profit companies

1.13 The company tax rate for a non-profit company that is not a registered organisation is gradually phased in.

- Taxable income of a non-profit company up to \$416 is not subject to tax.
- Where a non-profit company's taxable income is between \$416 and a given threshold, subsection 23(5) of the ITRA 1986 provides for a maximum amount of tax payable by the company, before any tax offsets. That maximum amount is worked out by applying a 55% rate to the difference between taxable income and \$416.
- Where a non-profit company's taxable income is greater than the threshold, the general company tax rate applies to the taxable income.

1.14 The threshold in subsection 23(5) is set at a level of taxable income where the amount of tax payable on that amount of taxable income at the general company tax rate equals the amount worked out by applying a 55% rate to the difference between that amount of taxable income and \$416. At the current 36% company tax rate, the threshold is set at \$1,204.

1.15 When the company tax rate is reduced, this threshold decreases. For a 34% tax rate, the threshold needs to be \$1,089. An amendment reflects this new threshold in subsection 23(5). [*Schedule 1, item 7*]

1.16 The effect of this amendment will be that non-profit companies pay the same amount of tax as they do currently up to a taxable income of \$1,089 (subject to tax offsets). Beyond that amount of taxable income, non-profit companies will pay less tax due to the lower company tax rate.

Changes for recognised medium credit unions

1.17 Credit unions fall into 3 categories for tax purposes: recognised small credit unions, recognised medium credit unions and recognised large credit unions.

1.18 Recognised small credit unions have a taxable income less than \$50,000. Recognised medium credit unions have a taxable income between \$50,000 and \$150,000. Recognised large credit unions have a taxable income greater than \$150,000.

1.19 The taxable income of recognised large credit unions is subject to the general company tax rate. Recognised small credit unions are exempt from tax.

1.20 Recognised medium credit unions are taxed in a way that gradually phases in the general company tax rate. This is achieved under subsection 23(6) of the ITRA 1986, which applies a flat tax rate to the difference between the taxable income of a recognised medium credit union and \$49,999. (The figure of \$49,999 is the threshold of taxable income above which a credit union becomes a recognised medium credit union.)

1.21 The rate set in subsection 23(6) provides for the same amount of tax payable on the difference between \$150,000 and \$49,999 as the general company tax rate would on \$150,000. (The figure of \$150,000 is the threshold at which a credit union becomes a recognised large credit union.) The rate in subsection 23(6) is currently set at 54% to reflect the 36% company tax rate.

1.22 The rate in subsection 23(6) needs to be reduced when the general company tax rate is reduced. For a general company tax rate of 34%, the applicable rate in subsection 23(6) is 51%. [*Schedule 1, item 8*]

Amendments for the 30% company tax rate

1.23 Schedule 2 to this Bill contains the proposed amendments to the ITRA 1986 to give effect to the 30% company tax rate for the 2001-2002 and later years of income. These amendments largely replicate the amendments made by Schedule 1.

The rate change for companies generally

1.24 This Bill proposes to amend subsection 23(2) of the ITRA 1986, which provides for the general company tax rate, to give effect to the proposed rate of 30% for the 2001-2002 and later years of income.
[Schedule 2, item 1]

Changes to rates pegged to general company tax rate

1.25 Like the proposed amendments in Schedule 1, the bulk of the amendments in Schedule 2 propose to change rates, applying to various entities, that are intended to reflect the underlying general company tax rate *[Schedule 2, items 2 to 6 and 9 to 11]*. The amendments proposed by these items exactly reflect those explained in Table 1.2, except that these amendments provide for a 30% rate instead of a 34% rate.

Change for non-profit companies

1.26 The reduction to a 30% company tax rate requires a change to the threshold for non-profit companies in subsection 23(5) of the ITRA 1986 along the lines of that explained in paragraphs 1.13 to 1.16 above. The applicable threshold for a 30% general company tax rate is \$915.
[Schedule 2, item 7]

Changes for recognised medium credit unions

1.27 The reduction to a 30% company tax rate also requires a change to the rate for recognised medium credit unions in subsection 23(6) of the ITRA 1986 along the lines of that explained in paragraphs 1.17 to 1.22. The applicable rate for a 30% company tax rate is 45%. *[Schedule 2, item 8]*

Components of taxable income for particular entities

1.28 Life insurance companies, registered organisations, RSA providers and PDFs have their taxable income divided into various components. Those components are taxed at different rates. Only those components reflected in Table 1.2 are to be taxed at the general company tax rate. Special rates apply to the other components.

Rates apply to net income in the case of trust estates

1.29 Generally speaking, the taxation of trust estates is currently based on an amount of net income. The company tax rate is intended to apply to trustees of corporate unit trusts and public trading trusts and trustees who are liable to be assessed and pay tax on behalf of non-resident corporate beneficiaries. The general company tax rate therefore applies in respect of net income in these cases.

The new rates also apply to corporate limited partnerships

1.30 The new rates will also apply to a corporate limited partnership because of section 94J of the ITAA 1936. The effect of section 94J is to treat a corporate limited partnership as a company for the purposes of the income tax law, including the ITRA 1986. Therefore, a corporate limited partnership is subject to the tax rate set out in subsection 23(2) of the ITRA 1986.

Application and transitional provisions

1.31 The amendments proposing the 34% rate apply to assessments in respect of taxable income (or in respect of net income of a trust estate) for the 2000-2001 year of income [*Schedule 1, item 12*]. This is the case even though the amendments commence on 1 July 2000 [*subclause 2(1)*].

1.32 The 2000-2001 year of income will commence for most entities on 1 July 2000. However, for entities with a substituted accounting period, that year of income will either commence before that date (in the case of early balancers) or after that date (in the case of late balancers).

1.33 The effect of item 12 is that the new rates will apply to all entities affected by the proposed amendments for their 2000-2001 year of income, regardless of when it commences.

1.34 Similarly, the amendments in Schedule 2 proposing the 30% rate apply to assessments in respect of taxable income (or in respect of net income of a trust estate), for the 2001-2002 and later years of income [*Schedule 2, item 12*]. This is the case even though the amendments commence on 1 July 2001 [*subclause 2(2)*].

Consequential amendments

1.35 Quite significant consequential amendments are required on account of a company tax rate change, particularly to the imputation provisions in Part IIIAA of the ITAA 1936.

1.36 These amendments will be made in conjunction with other proposed changes to imputation arising from the Review.