DEWINGS
ACCOUNTING + CONSULTING

Welcome to our latest e-newsletter.

You may have noticed we've been gone for a while! It had been our intention to provide some clarity on the practical implications of the company tax rate cuts, including the impact on franking credits, but there has been so much uncertainty about how these cuts are to be implemented that we had to keep putting this issue on hold and re-writing it as more information came to hand. Even now the landscape ahead is far from clear, and we've considered numerous theoretical instances over the last few months where the implications for a company would be, at best, difficult to determine. At the very least, most companies that have retained earnings and receive the benefit of the tax cut will be penalised with a hit to their franking account. Read on for more detail.

In other news, Single Touch Payroll will be mandatory for employers with 20 or more employees from 1st July 2018, and on that same date, online shopping may start costing you more.

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When a rate cut might be a two-edged sword

It was around 18 months ago now that the Government announced its intention to introduce a staggered reduction in the rate of tax paid by companies. Aside from the extended timeline for implementation, the ultimate goal was pretty simple - within a decade the company rate would

be 25% for all companies. Proving just how small a step it is from the sublime to the ridiculous, the Government has since managed to turn that relatively positive initiative into a complete debacle, particularly when it comes to passive companies.

The first round of the company tax rate cut – a reduction to 27.5% for 2016-17 – was linked to an existing range of measures known collectively as the small business concessions. To be eligible for these breaks, a company had to be 'carrying on a business', and have annual turnover less than $2 million. That turnover level was increased to $10 million for 2016-17, but aside from that, the eligibility criteria remained unchanged. As such, it followed that a company needed to be a 'business' enterprise to be entitled to the cut.

This is in contrast to a 'passive' company. Some companies exist predominately to receive and manage non-business income, such as interest, dividends and trust distributions. They are commonly used by people operating their own businesses as mechanisms for asset protection and tax planning, and have always been deemed to be not carrying on a business for the purpose of the small business concessions. It was therefore assumed that passive companies would also not be eligible for the lower tax rate and continue to be taxed at 30%.

This would mean that there would be two sets of company tax rates, even for companies with otherwise similar turnover levels. But to some extent, we had already grown accustomed to this complication. Since 1st July 2015, the company tax rate had been 28.5% for small businesses (those with turnover less than $2 million) and 30% for all other companies - including passive companies below the turnover threshold.

But then the Tax Office threw a curveball. A Ruling was issued in relation to a different matter, which happened to contain a provision stating that any company set up for a profit-making purpose could potentially be considered a business enterprise. This would fundamentally bring into question the notion of what it meant to be carrying on a business for tax purposes, and would seemingly extend the new round of tax cuts to all companies – including passive enterprises. The Government then contradicted this by reaffirming its view that the new rate was not intended to be extended to passive companies. So which view was right?

As industry bodies and tax professionals frantically sought clarification, both the Tax Office and the Government went silent. It's worth noting that this uncertainty continued well after the end of the financial year to which the first round of cuts was to apply – 30th June 2017. So there were companies that were technically able to lodge a 2017 Income Tax Return but couldn't because they didn't know how much tax they should pay! There were also companies that did in fact lodge their tax returns during this period and which may now need to amend.

At this point, you'd be right in thinking that this whole thing was poorly managed. But even then, surely the solution would ultimately be found in simply choosing one option or the other, wouldn't it? At some point, after some discussion and debate, the outcome would have to be that either eligible passive companies would be taxed at the existing rate of 30% (a continuation of the existing practice) or they would be brought in under the new rate.

Instead, months after the end of the financial year, things got worse. On 18th October 2017, the Tax Office issued a draft Ruling entitled "Income Tax: when does a company carry on a business within the meaning of section 23AA of the Income Tax Rates Act 1986?" (Section 23AA is the relevant provision governing the application of the rate cut to companies from 1st July 2017). Note in that title the explicit reference to 'business' – signalling, one would assume, an intent to clarify once and for all what it would mean to be carrying on a business in this context.

On ***the same day,*** the Government decided to crush any possible dispute with the Tax Office by releasing a Bill into Parliament repealing section 23AA altogether, replacing it with a new definition governing eligibility for the new tax rate and removing any reference to carrying on a business. Just to confirm that you're reading this correctly (because it may seem almost nonsensical) – the Tax Office issued a Ruling on a section that was repealed on the very same day by the Government!

The Government's Bill provided that for the 2017-18 financial year, companies eligible for the new rate (now those with turnover less than $25 million) would be called 'Base Rate Entities' (BREs). A company would be considered a BRE where less than 80% of its income came from passive sources. In other words, more than 20% of its income must be derived from business sources.

The fundamental change here is that under the existing small business rules, eligibility is determined by looking to the *activities of the company*, whereas under the new Bill, it doesn't matter what the company does. Eligibility is now determined by the *character of the income*. The company may not carry on any business itself, but if (for example) it receives income that is derived from a trust that carries on a business, it may now use the new rate (assuming it has income below the relevant threshold).

This is relevant for eligible companies that receive trust distributions from active trusts. Whereas they would have been considered passive up to the end of the 2016-17, they will now be active and subject to the 27.5% rate for 2017-18.

You would think that both the Tax Office and Government would publicly acknowledge that the left hand has not been talking to the right, and go back to the drawing board collectively. Instead, they now appear to be in PR mode, attempting to save face by awkwardly reconciling the two contradictory positions. The Tax Office has now recently confirmed that their Ruling will apply for the 2016-17 year (and prior), with the Government's new Bill having application for 2017-18 onwards. Even so, certain

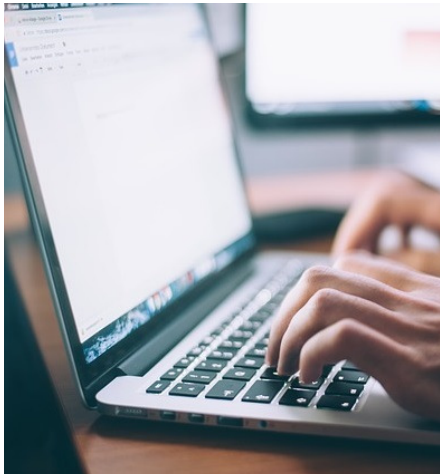
clarifications within the Tax Office Ruling (which, remember, applies for the 2016-17 year and before) may actually change existing practice in some cases, and could therefore require past Income Tax Returns for companies in this situation to be amended. That is, 'clarification' has muddied the waters further.

The result of all this is that every company will need to be considered on a case-by-case basis, year-by year, to determine which rate of tax it will pay. It's likely to be the case for some companies that they won't know what rate of tax they will have to pay until the end of the financial year, and may in fact pay a different rate year to year. It's also conceivable that a company may pay the lower rate one year, and then go back to the higher rate the next.

And there's more bad news for some business owners too. Dividends paid in 2017 and beyond, where a company is eligible for the new rate, will only get franking credits of 27.5%, even if tax may have been paid by the company, in previous years, at 28.5% or 30%. In effect, where there are retained tax profits in a company, this is an actual cost to the business owners to the value of the lost franking credits. For some, this could amount to thousands of dollars or more, and it turns out this was an intended consequence in order to help finance the company tax rate reduction measure. That is, these provisions intentionally penalise many businesses that are eligible for the rate reduction.

This entire process, which was intended as a win for business, has turned into a debacle on a scale rarely seen before - and for very little net gain for business owners. It was perhaps best described by Professor Bob Deutsch, senior tax counsel at The Tax Institute. *"This whole saga is a good example of how not to develop tax policy – a move to reduce the corporate tax rate from 30 to 25 per cent, what should be a straight-forward exercise, has led to a plethora of rates cascading down over a number of years; confused definitions of carrying on a business and passive income; problems with changed arrangements for franking credit utilisation and generally an enormous amount of wasted time and energy. The government and most particularly the Senate have much to answer for in regard to the creation of this mess."*

At a time when the business community is pleading louder than ever for relief from the burden of Australia's complex tax system, the result of this latest chapter – one of many in recent years that indicate that these cries are going unheeded – is yet more red tape and a further increase in the cost of compliance.



Single Touch Payroll is coming

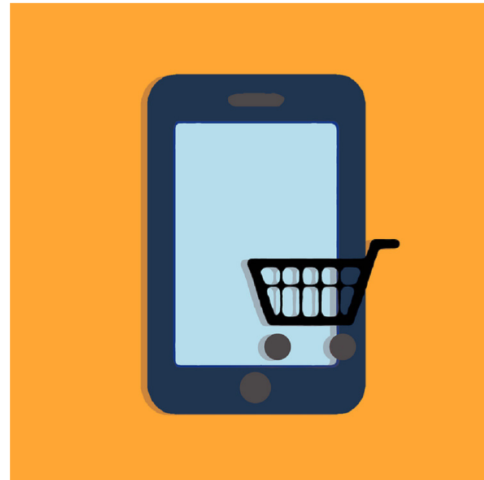
Back in 2016, legislation was passed to change the way in which payroll data was to be collected for many businesses.

The new system is known as Single Touch Payroll Reporting and will be mandatory for businesses with 20 or more employees from 1st July 2018.

What is Single Touch Payroll Reporting (STPR)?

Put simply, STPR automates the reporting of payroll information to the Tax Office (ATO). Rather than periodically sending historical payroll information (most commonly through a BAS and an annual PAYG report), data is sent electronically every time a pay cycle is completed within a payroll software application.

The Government suggests that the new system will be more efficient for employees and employers in a number of ways, including prefilling the payroll data on a BAS, eliminating the need for end of year reporting, providing centralised payroll information to



Online shopping might cost you more from 1st July 2018

If you're an avid online shopper, you may have been aware that the Government was planning to curtail the good times by requiring GST to be paid on low value goods ordered from overseas. This change was due to come into effect from 1st July 2017, but implementation has been deferred until 1st July 2018 through the passage of the Treasury Laws Amendment (GST Low Value Goods) Bill 2017.

Under current law, when a consumer orders something from overseas and the value is less than $1,000, no GST is payable.

Understandably, with the smaller world created by the internet and an increasingly global economy, Australian retailers saw this as a competitive disadvantage for them. Online goods often cost less to begin with because of the reduced overheads in not operating 'bricks and mortar' stores. Items purchased from overseas vendors can be cheaper again because of a range of factors, including higher wages in Australia and the inefficiencies of having a relatively low population spread across vast distances. Plus of course there's the impact

employees through their myGov account, and providing an online method of submitting TFN and superannuation details for new employees.

In reality, however, the prime motivation is likely to be that more timely data will be gathered by the ATO for matching purposes, while optionally, the payment of payroll liabilities such as PAYG Withholding Tax may be brought forward to occur with each pay run.

Who does it apply to?

STPR becomes mandatory for businesses with 20 or more employees from 1st July 2018. To complicate things further, the number of employees is determined based on a head count on 1st April 2018. Businesses with less than 20 employees may still choose to opt-in if they consider the benefits to be valuable enough.

What do you need to do?

1. **Head count** – If you're close to the 20 employee mark, or even if you're not now but your employee count fluctuates significantly around that mark over the course of a year (e.g. you employ seasonal workers), make a note to do a head count on 1st April 2018.
2. **Check your payroll software** – If you have 20 or more employees on 1st April 2018 (or you know now that you are likely to), make sure that your payroll software is (or will be) STPR capable and ready by 1st July 2018. If you don't use payroll software at the moment and are

of the so-called 'Australia Tax' imposed by overseas multi-nationals on goods sold domestically. The GST exemption on goods under $1,000 was viewed as yet another barrier for Australian retail to overcome, and there had been calls for some time to review it.

The problem though had always been one of basic economics. The revenue that could be collected from imposing GST on imported goods less than $1,000 would be far outweighed by the cost of enforcement. Such goods would need to be intercepted on arrival and screened, their value assessed, GST levied and collected.

In what is now becoming a trend, the solution to this dilemma has again been found in shifting the cost of revenue collection onto business. Suppliers of overseas goods with an Australian turnover exceeding $75,000 will now be required to register for, and charge, GST on goods with a value of less than $1,000 from 1st July 2018. It remains to be seen how the Australian Tax Office will enforce the measures on a business that is entirely owned and operated in an overseas jurisdiction, but one would suspect that such operations may not have much concern for their obligations under Australian tax law when there is no means of enforcement.

Significantly however, it does extend to operators of online distribution platforms - marketplaces that connect sellers and buyers. Think eBay, Amazon, etc. These platforms are more likely to have an Australian presence where they are subject to Australian tax, but are open to overseas sellers. Under this measure they will also be required to collect GST on low value goods sold by overseas vendors who sell

likely to be affected, you will need to acquire a solution and have it set up ready to go by the start of next financial year.

If you already use payroll software, and it will be STPR ready, most of the work will be done by the application, with some initial setup required.

There will be a transitional period of 12 months grace where penalties will be remitted for genuine errors or where reporting is not completed on time.

If you think you may be affected, please contact us.

under their banner. eBay initially indicated that it would block access to overseas vendors if these new requirements were to be implemented, but with another year now to work things out, there has been no further announcement.

It's almost certain though that some goods sold through online retailers will be more expensive from 1st July 2018, while some commonly used online retailers may become more restricted or even unavailable.

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