Reduced 26% company tax rate starts 1st July

In a little bit of non-COVID news, the company tax rate is set to reduce from 27.5% to 26% on 1st July this year, for 'base rate' entities. This isn't a new measure, but rather is in accordance with the timeline of cascading rate cuts **passed by Parliament a few years back.**

What's a base rate entity?
There is a very technical definition for a base rate entity. It's a company that has an annual turnover of less than $50 million, where passive income makes up 80% or less of its assessable income. 'Passive income' includes items like interest, dividends and so on. So looking at it the other way, a base rate entity must derive at least 20% of its income from business operating activities.

In simple terms most small-medium businesses that operate through a company would be base rate entities, and therefore eligible for the reduced rate. A company that is not a base rate entity (and therefore still pays tax at 30%) might be, for example, one that is predominately used as an investment vehicle.

What does this mean for your company?
On the face of it you might think a tax cut is a good thing, but as we highlighted at the time, this series of tax cuts is as much about Government PR as anything else. You'll eventually have to pay the tax saved, at personal marginal rates, when you take it out of the company, and worse, each time the rate reduces, you lose the equivalent value in franking credits for tax previously paid. So it's conceivable that for some small business owners, instead of a saving, there is a net cost each time the rate reduces!

Firstly then, if you're in the habit of paying profits out of your company each year as dividends, you may want to give consideration to whether you should declare a dividend before 30th June to ensure you get a credit of 27.5% rather than 26%. Because personal rates are unchanged, you will pay any difference personally, so paying a dividend after 30th June may result in an extra 1.5% tax being payable in your personal income tax return.

There are other tax planning considerations too. If you have any large expenditure due in the near future, bringing it forward into this financial year will get you a deduction at the higher rate of 27.5%. This may be particularly relevant if you're thinking of taking advantage of the recently extended $150,000 instant asset write off limit. That deduction will save you an extra 1.5% in tax if you can have the asset installed and ready for use before 30th June.

Likewise, if you can defer income until after 30th June, it will be assessed at the lower rate of 26%, so it may be worth looking at whether any sales or services, and/or the invoicing for the same, can be deferred until next financial year.

A change in the company tax rate at any time requires some additional tax planning consideration prior to end of the year. In this case however, when the effective value of any accumulated franking credits will be diminished, additional attention should be given to how you can minimise the negative impact.

NOTE: The company tax rate cut is scheduled to take effect from 1st July. While the measure is legislated, the Federal Budget announcement for this year has been deferred from its usual May date to 6th October 2020 because of the coronavirus pandemic. With the magnitude of Government spending on support and stimulus measures, we can't rule out the possibility that this (and future cuts) are postponed or rescinded indefinitely. This may seem inequitable given that the new financial year would be more than a quarter over by Budget night, and it may be months more again by the time any changes are legislated. These are, however, unprecedented times, and retrospective changes that create uncertainty and throw tax compliance activities into disarray are not without precedent**. Naturally this means that tax planning prior to 30th June should be undertaken with the understanding that the landscape may change post-Budget night and render those actions less effective.**

If you would like to discuss your circumstances further before the end of the financial year, or have any other questions, please contact us **for further information or assistance.**

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