BDO TAX INDUSTRY INSIGHT

THE REAL IMPACT OF REDUCTIONS IN THE CORPORATE TAX RATE

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Business groups have lobbied hard for small business company tax rate changes that will result in savings that can be reinvested by companies into technology, encourage investment in Australian companies, especially those in the technology, media and telecommunications (TMT) sector, and provide tax relief to growing businesses. Whilst the changes are welcome along with the flow on effect to the R&D tax incentives that support innovative, high-growth potential start-ups, the tax implications need to be closely examined, so the small companies that the legislative change was intended to assist, are supported rather than burdened.

REDUCTION IN THE CORPORATE TAX RATE NOT ALL GOOD NEWS

As part of the Federal Government's 10 year Enterprise Tax Plan, the income tax rate for small corporate taxpayers was reduced from 28.5% to 27.5% for the 2016–17 income year for small business entities with aggregated turnover of less than $10 million (which is an increase from $2 million in previous years). This long overdue tax change was welcomed by many small Australian companies in the Technology, Media and Telecommunications (TMT) sector. Subject to meeting other statutory requirements, the turnover threshold that applies for a corporate taxpayer to qualify for the lower income tax rate will increase annually from $10 million in the 2017 financial year to $50 million in the 2019 financial year.

While this may seem like great news for the company and its shareholders, it is not all good news when you crunch the numbers. If small companies on the 27.5% tax rate pay dividends, the total tax paid by the company and shareholders will be greater than if the company remained at the 30% tax rate. In other words, the extra tax can arise due to the trapped franking credits in the company which is a real tax cost for the shareholders because it will increase the top-up tax payable by the shareholders, and the 2.5% franking credit is left behind in the company and all other things being equal, is effectively wasted. This problem first had an impact on companies with less than $10m turnover that became entitled to the 27.5% tax rate from 1 July 2016. Going forward, this problem will be exacerbated when the 27.5% tax rate kicks in for companies with less than $25m turnover for the 2018 financial year and $50m turnover for the 2019 financial year.

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PASSIVE INCOME IS EXCLUDED

Another problem accompanying the reduced company tax rate was recently addressed by the Federal Government when it released draft legislation on 18 September 2017 for consultation. The draft legislation clarifies that passive investment companies are not eligible for the lower income tax rate. Prior to the release of the draft legislation, many small companies were unsure as to whether they could access the reduced corporate tax rate. The exposure draft bill amends the tax law to ensure a company will not qualify for the lower income tax rate if 80% or more of the income derived by the company in the relevant financial year is of a passive nature (e.g. dividends, royalties and interest income).

CASH FOR START-UPS AND FUNDING GROWTH THROUGH THE R&D TAX INCENTIVE

Registration to claim R&D tax incentives for the 2017 financial year is now available for eligible entities.

The R&D tax incentive provides a tax offset for eligible R&D activities and is targeted at R&D activities which benefit Australia. The tax incentive aims to mitigate costs associated with eligible R&D activities and may be available for companies in the TMT sector, including start-ups.

TMT companies should determine whether they have undertaken eligible R&D activities in the 2017 financial year. Eligible R&D activities are not limited to high-end scientific research and complex software development but can include a broader spectrum of development activities.

With the reduction in the income tax rate for small corporate taxpayers, the potential R&D tax benefit has also changed for companies accessing the R&D Tax Incentive for the 2017 financial period. This is because for companies in a profitable position, the benefit of claiming R&D is equal to the R&D tax offset amount less the corporate tax rate.

The refundable R&D tax offset was decreased to 43.5% (from 45%) and non-refundable offset has decreased to 38.5% (from 40%) in 2016 when the Government's raft of proposed reductions to the corporate tax rate were announced.

While there is a downside to the 1.5% reduction of the R&D offset rate, interestingly small companies may be entitled to an increased effective benefit from accessing the R&D tax incentive as a result of the reduction of the small corporate tax rate by 2.5%.

From 1 July 2017 the proposed threshold for the 27.5% tax rate has been further increased to $25 million, so more companies will be able to qualify for the corporate tax rate cut as well as receive the additional 1% tax saving when they apply the R&D offset (43.5% less than the new 27.5% tax rate, which provides a 16% permanent benefit). If the ten-year corporate tax rate reduction proposal passes, the net benefit of claiming will increase each year which would be positive news, however there is no word yet on whether the R&D tax offset will also be altered to account for the reduced rates.

In the meantime, to receive the R&D tax incentive, the R&D entity must register its R&D activities with AusIndustry within 10 months after the end of the entity's income year. Therefore, companies with a 31 December 2016 financial year end, have until 31 October 2017 and companies with a financial year end 30 June 2017 have until 28 April 2018 to submit their applications.

BDO COMMENT

We expect that TMT companies that do achieve a saving from the small business corporate tax cut, will invest this back into their businesses, which is usually in the form of an investment in technology. However, Australia's competitiveness will suffer until we have a Government prepared to tackle real taxation reform incorporating further relief and incentives for investment in technology. While the proposed company tax rate cuts over the next decade are welcome, further expanding the benefits of the R&D tax incentive will, in our opinion, improve the survival rate and growth prospects of early stage businesses and boost the economy overall.

MORE INFORMATION

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