CHAPTER 5

COMPANY TAX

5.1 Company tax is levied on companies separately from the income of its shareholders. It was introduced in 1976/77 financial year. From 1978/79 it was collected mostly in quarterly instalments on an arrears basis. In l99o, the payment arrangements were changed to a lump sum system.

5.2 Then in 1993, a new system of company tax instalments was enacted. As proposed it applied to:

- small taxpayers (tax liability less than $8ooo) for the 1994-95 year of income;
- medium taxpayers ($8000 - $300 1000) for the 1994-95 year of income; and
- a large taxpayers (over $300,000) for the 1995-96 year of income.

5.3 Table 5.1 shows how company tax was paid between 1989/90 and 1993/94. Table 5.2 summarises the new arrangements that were to have applied from 1994/95 and 1995/96.

Compliance Dates

,Small Taxpayers

5.4 Upon notification of the proposed changes, opposition arose from small businesses and their tax agents because the new compliance dates meant that the year's flow of work would be compressed into a six month period. (Many accountants also lodged submissions to this inquiry protesting against the new arrangement.)

5.5 After consultation with the Tax Office, a compromise arrangement was reached (Appendix IV). The agreement, which will apply for 1994/95 only, allows small businesses with tax liabilities of $8,000 or less to revert to the previous lodgement arrangements. A review by the Tax Office is currently being undertaken to determine long-term arrangements.

Table 5.1: Operation of the payment system for companies with 30 June balance dates prior to 1994-95

Tax Liability	**Payments required**	**Due date after end of year of income**
$20,000 or more	Initial payment: 85% of notional or estimated tax Final payment: balance of total tax liability	28 July (28 Sept for 1993/94 for $1,000 to $300,000) 15 March
Between $1,000 and $20,000	Initial payment: 85% of notional or estimated tax Final payment: balance of total tax liability	28 July (28 Sept for 1993-94 for $1,000 to $300,0000) 15 March
	<u>OR</u>	
	One single payments of 100% of total tax liability	15 December
	One single payment of 100% of total tax liability	15 March
Less than $1,000		

Table 5.2: New system of company tax payment arrangements.

Year of Income	**Tax Liability**	**Payments Schedule**	**Due date after start of year of income**
1994-1995 and after	Less than $8,000	Full amount by single instalment	1^{st} day of 18^{th} month after start of year of income (usually by 1^{st} Dec)
1994-1995 and after	Less than $8,000 to $300,000	Quarterly instalments, 25% of likely tax in first three quarters with actual tax assessed less instalments already paid.	By the first day of the 12^{th}, 15^{th}, 18^{th} and 21^{st} months (usually 1 June, 1 Sept, 1 Dec and 1 Mar)
1995-1996 and after	More than $300,000	Quarterly instalments, 25% of likely tax in first three quarters with actual tax assessed less instalments already paid	By the first day of the 9^{th}, 12^{th}, 15^{th} and 18^{th} months (usually 1 march, 1 June, 1 Sept and 1 Dec)-except that the first instalment is waived for 1995-1996

Medium Taxpayers

5.5 Evidence to the Committee expressed some opposition payment schedules which will come into effect in 1994195 for small to medium businesses with tax liabilities of $8,000 or more. Whereas the previous payment system allowed for instalments to be paid in the following year of income (,Table 5.1), the new regime for businesses with tax liabilities of $8,000 or more will require payments to commence within the current year of income (Table 5 . 2).

5.7 The ATO and Treasury commented that:

> Although some company tax payments will be brought forward under the quarterly instalment systern, some will also be delayed. The changes should result in lower financing costs for small and medium expressed some opposition to the new businesses because, on average, they will result in a net deferral of tax payments.

5.8 However, some submissions asserted that as these 'medium' taxpayers (that is: with tax liabilities of between $8,000 and $300,000) will have their first instalment of 25% for 1994195 payable on 1 June 1995, they will pay 125% of what they would otherwise have paid in 1994195.

5.9 ATO and Treasury, in their joint submission to the Committee, advised that under recently enacted changes to the imputation system, a franking credit arises in a company's franking account at the time it pays a company tax instalment. They also commented that:

> For medium and large instalment taxpayers, who will pay their first instalment during the income year to which the company tax instalment relates, this means that companies will now be able to pay dividends during the income year which are franked with imputation credits corresponding to the first instalment ... This change to the imputation system effectively permits companies to distribute **as** franked dividends duriny the income year some of the profits which are derived in that year.

5.10 ATO/Treasury consider that this should largely alleviate concerns about the timing of the first instalment during the first income year, 1994195.

Small 'Medium' Taxpayers

5.11 One group of company taxpayers which may have been disadvantaged are those that are in the $8,000 to $20,000 bracket of annual company tax liability. Under the previous payment arrangements, these taxpayers had a choice of making an initial payment 85 per cent of their notional tax by 28 September (for 1993-94), with the balance being payable on 15 March following, or simply paying the entire company tax liability by 15 December after the end of the year of income. Under the new arrangements, these companies are now required to pay by quarterly instalments commencing on the first day of the 12th month after the start of the year of income, usually 1 June.

5.12 As the ATO/Treasury submission asserts, this may represent, on average , a net deferral of tax payments due to the fact that by 15 December, 75 percent of notional tax will have been paid against the 85 percent notional tax or 100 percent actual tax allowed under previous arrangements. Nevertheless, the volume of tax payments that have been brought forward represents a sudden and significant shift in cash flow which in many cases, particularly for companies that are in the bottom end of the 'medium' taxpayer spectrum, may only be readily absorbed if sufficient notice is given to allow forward planning.

5.13 A submission was received from one of these companies which complained that it had received inadequate notification of this change from the ATO , maintaining that the leaflet which it received from the ATO tax agent had not been received until February 1995, although it was dated December 1994. The consequence for this particular company was that between December 1994 and February 1995, it had budgeted for its cash flow on the basis of a single December 1995 tax payment, and had committed substantial funds to non-urgent expenditure on their premises, which they maintain they would not have done if they knew that a first instalment was due on 1 June 1995.

5.14 The Committee is concerned that this apparent inadequacy of notification of significant changes to the legislation may have adversely affected a substantial number of company tax payers. Statistics reveal that in the 1992-93 income year, 22,83l companies paid net company tax of between $8,000 and $20,000 each.

Recommendation 5.1

The Committee recommends:

(i) that the Government investigate the adequacy of the notification of the new company tax arrangements, in particular, to those companies with company tax liabilities of between $8,000 and $20,000; and

(ii) that the Government ensure that taxpayers which are affected by changes in the legislation are properly notified well in advance.

Threshold to Quarterly Payments

5.15 KPMG Peat Marwick submitted that the $8,000 threshold was too low as many small businesses are classified as medium taxpayers liable to quarterly instalments, increasing their administrative burden.6 **A** number of submissions were received arguing the opposite view, namely, that small companies should be given the opportunity to make quarterly payments to ease cash flow which is easily disrupted with the imposition of a lump sum tax liability.

5.16 The question of thresholds was raised a number of times in submissions and in evidence. The Tax Office and Treasury acknowledged that there are some inconsistencies, for example between the FBT and company tax thresholds While the question of thresholds is clearly of importance to small business, as is the consistency between thresholds on the various taxes, they should not restrict the options available to small business. Clearly, lower thresholds are intended to cushion smaller businesses from the more rigorous requirements applying to larger businesses. Nevertheless, a number of small businesses would be happier paying their company tax liabilities on a quarterly basis, rather than as a lump sum. As the administrative systems which implement the quarterly arrangements are already in place, there seems to be no reason why small companies should not be given the opportunity to opt into alternative payment arrangements available to larger taxpayers.

5.17 An associated issue is that 'small' taxpayers for the purposes of company tax payment schedules do not necessarily equate with small businesses. The NTAA pointed out that a 'small' company taxpayer may be a very large business experiencing a downturns. A 'medium' taxpayer may be in the same situation. There seems no reason to force such a company into an alternative payment schedule for that reason.

Recommendation 5.2:

The Committee recommends that 'small' and 'medium' company taxpayers be permitted the option of paying their tax instalments on a quarterly basis applicable to either 'medium' or 'large' taxpayers.

Company Tax Rate

5.18 Direct comparisons of company tax rates with other countries is not a particularly useful exercise, as a range of other variables, both tax and non-tax, influence domestic and international investment considerations. The Committee notes, however, that the high effective tax rates on investments faced by Australian investors in Australia and most overseas countries, has been attributed to the emphasis on income and company tax in the Australian tax system.10

5.19 The Committee heard evidence to the effect that a progressive or. semi-progressive (that is: two tier) company tax rate regime operates in a number of other countries. In the UK, companies with profits of below £250,000 pay 25 per cent company tax while companies above this threshold pay 35 per cent company tax." in addition:

> It is quite common to have some lower figure for the first so many hundred thousand dollars of income - in part, as recognition of the costs of collection for small business.

5.20 The idea of progressive tax is well entrenched within the PAYE and provisional tax regime, yet it is absent from the company tax regime. The relatively high tax rate (compared to overseas), coupled with high compliance costs sustained by small businesses, suggest that some compensation could be extended to small businesses to counter these disadvantages.

5.21 The threshold which could apply in these circumstances depends upon the extent of the concession sought and which measures are used to determine the threshold. The proposed elevation of the company tax rate to 36 per cent announced in the recent Budget leaves the way open for the rate for small companies to be left at 33 per cent, or even lowered. An important consideration would therefore be the question of what constitutes a small company.

5.22 There are several ways in which a small business can be defined: by the number of employees; the annual turnover of the business; the amount of assessable income received; the amount of taxable income received; or the amount of tax paid. Using a threshold based on profits may be a dubious measure as a majority of companies do not pay tax. Some 60 per cent of companies are classified by ATO/Treasury as 'non-taxable'. Of the remaining 40 per cent, 95 per cent were private companies which paid less than half the company tax revenues paid by the remaining 5 per cent (public and 'other' companies).

5.23 Because of the potentially conflicting definitions, it is not at all clear what really constitutes a 'small' company. There may not necessarily be a correlation between tax collections and business incomes, or between business incomes and number of employees receiving salary or wages. Progressive company tax scales used overseas often base company tax thresholds upon taxable income. The drawback with this approach is that taxable income is not necessarily a measure of the size of a business, as the bulk of company business (assessable) income is usually reduced through deductions. Furthermore, during periods of economic downturn even the largest company can post a loss. A more realistic threshold would therefore be a composite based in the number of personnel employed by the company and taxable income.

5.24 The Committee considers that the establishment of a lower company tax rate for low income 'micro-businesses' (with fewer than 5 employees) could compensate those businesses for the higher compliance costs they sustain. It suggests that the Government review the compliance costs of small companies with a view to setting a company tax rate to apply to small companies which is consistent with offsetting these compliance costs. The Committee reiterates its recognition of the relative burden of compliance costs to small business vis~a-vis larger businesses and urges the Government to take this into consideration when framing new legislation.