Australia adds to corporate burden

An increased rate of company tax is only one of the tough revenue-raising measures included in the 1995-96 Budget. The changes to the dividend franking regime have important implications for Australian companies. By Ian Dinnison of Arthur Andersen, Melbourne

The 1995-96 Australian Budget was handed down on May 9 1995. It hit business fairly hard. Company tax and fringe benefits tax are increased and amendments to the capital gains tax rules make many forms of corporate restructuring more complex.

Company tax rate

The company tax rate is increased from 33% to 36% with effect from the 1995-96 income year. Accordingly, most companies with December 31 balance dates pay the higher 36% rate from January 1 1995.

This will raise additional revenue of A$320 million (US$230 million) in 1995-96 from early-balancing companies, and A$1,750 million in 1996-97. This will increase the rate at which companies can pass tax credits to shareholders under the imputation system through franked dividends, resulting in smaller revenue effects in future years.

To avoid complexities for both companies and shareholders with the introduction of a third franking account, the system for maintaining franking accounts will be simplified. All companies will be obliged to convert their A and B class franking surpluses to a C class from the 1995-96 year of income. This will not be a mere re-labelling exercise, but will involve arithmetic adjustments to existing balances to equate them to after-tax profits at the 36% tax rate.

Because of the arithmetic adjustments, Australian subsidiaries of multinationals which have significant balances of credits from having paid tax at the 33% rate should consider paying out franked dividends before they are converted to lesser C class credits.

International tax changes

A technical amendment removes the argument that non-resident shareholders are exempt from capital gains tax on the disposal of Australian company shares where these shares are used solely to derive dividend income.

A change will be made to the imputation provisions to deny franking credits generated from the payment of tax under transfer pricing adjustments. This amendment has effect for original and amended assessments relating to transfer pricing and non-arm's length dealing adjustments issued after May 9 1995.

Superannuation and national saving

Retirement income is to be funded by a double measure of superannuation. The two-pronged measures referred to as co-contributions are:

- a compulsory 3% employee contribution; and
- a government contribution.

The combined level of employer, employee and government superannuation support is shown in the table on page 26.

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Compulsory 3% employee contribution

This is to be introduced through industrial awards and agreements. The contribution will be phased in over a three-year period beginning July 1 1997.

To qualify for the government contribution, employee contributions must be contributed to the same fund as employer superannuation guarantee contributions. They will also be subject to preservation.

Whether employees will be able to salary sacrifice their contributions is not addressed. Further, the Budget does not provide tax relief to employees on their contributions nor is there any exemption for low income earners. There is no maximum contribution limit for employees similar to that for the superannuation guarantee.

Where the employees already make 3% or more contributions out of after-tax income, no further payment is required.

Government contribution

The government will match contributions on a means-tested basis for both employees and the self-employed.

The government contribution will be capped at 3% of average weekly ordinary time earnings (AWOTE), ie about A$1000 a year, and will be phased out at twice AWOTE. Therefore, anyone earning more than A$56,600 will not qualify for the government contribution. These people lose out because they do not receive the tax cuts that were previously promised but will now be used to fund the government contributions.

The first payment by the government will be made in the 1998-99 year of income for employees, and the 1997-98 year for the self-employed.

Sales tax

The Budget represents the largest increase in sales tax revenue (up A$2.6 billion) in the last decade. New initiatives to remove "existing disparities" are in fact a

Superannuation contributions				
Year	Employer contribution	Employee contribution	Government contribution*	Total
1994-95	5	–	5	
1995-96	6	–	6	
1996-97	6	–	6	
1997-98	6	1	1#	8
1998-99	7	2	2#	11
1999-2000	7	3	3#	13
2000-01	8	3	3	14
2001-02	8	3	3	14
2002-03	9	3	3	15

* To be subject to a means test

\# Government contributions will first be paid to employees in 1998-99 and to the self-employed in 1997-98.

simple base-broadening exercise that create as many anomalies as they resolve. The new measures will increase sales tax revenue by A$702 million in 1995-96.

Building materials

A number of building materials become subject to sales tax at the rate of 12% from July 1 1995. This could be the first step to bringing all building materials within the sales tax net.

The products to be taxed include:

- builder's hardware such as bolts, screws, nails, nuts, washers, hinges, knobs, locks;
- wall and floor tiles;
- plaster and plaster mixtures, but not sheet plaster or other plaster products;
- taps, nozzles, tap handles and shower heads;
- glues, binding and sealing agents;
- wallpaper, paints, putties, filler, thinners; and
- prefabricated joinery, including kitchen and other cupboards and office partitioning.

These provisions do not come into force until July 1 1995 to allow wholesalers of such products enough time to prepare for the tax.

Motor vehicles

As predicted, the sales tax for non-luxury passenger vehicles rises from 16% to 21% immediately. The amendments will also have a similar follow-on increase in the total tax paid on luxury vehicles. The government anticipates this will add 3.5% or A$690 to a A$20,000 car.

Tax-advantaged computer programs (TACPs)

The existing exemption of computer programs on microchips is removed with immediate effect. The concessions will remain for software embodied in other types of media, eg recorded on diskettes, CD Rom etc, and for games cartridges and the like. This is a major initiative. The Treasurer's press release indicates that software exemptions ranged from 32% to 50% for mobile phones, 60% to 70% for computers and 20% for white goods.

Base "protection"

In a range of increases aimed at overturning unfavourable court decisions and pre-empting pending litigation, the following amendments have been announced as being effective immediately:

- pianos, organs, bric-a-brac, free-standing floor and wall safes, scaffolding components, model aircraft, and racking and shelving are taxed at 21%; and
- refund claims outside the sales tax system (ie going back more than three years) are outlawed.

Excise

A range of excise amendments will increase revenue by A$201 million in 1995-96. The most important change is the excise increase for light fuel oil which will be taxed at the same rate as diesel from July 1 1995.

Many industrial and non-road fuel users have moved to light fuel oils as a cheaper alternative to diesel. The government's initiative will restart the debate on the level of excise applied to non-road fuels. Similar arrangements to the diesel fuel rebate scheme will apply to light fuel oil.

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Other announcements include:

- excise on tobacco and tobacco products increase 10% from May 9 1995; and
- a A$23 million increase in excise on aviation fuel.

Other business tax changes

Dividends which are debited to share capital accounts, share premium accounts or revaluation reserves of the dividend-paying company are no longer rebateable or frankable. There are also changes affecting off-market share buy-backs. Measures will counter non-market value consideration payable under non-arm's length off-market share buy-backs.

Debts forgiven after May 9 1995 reduce the debtor's future tax deductions in the following order: prior revenue losses, prior capital net losses, un-deducted balances of capital expenditures and cost bases of capital assets.

New rules restrict trafficking in trust losses. In future, for trusts to use losses certain tests, including a continuity of ownership test, a same business test and an income injection test, must be satisfied. This could prove a major problem for the acquisition of trusts that have a genuine trading business.

The Medicare rate increased from 1.4% to 1.5% of income with effect from July 1 1995. In line with this increase, the fringe benefits tax increases to 48.475% from April 1 1995 (a proportionate increase) and to 48.5% from April 1 1996. This is to prevent any salary packaging advantages which might otherwise arise if the fringe benefits tax rate was left unchanged. ❑