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Technical Accounting Alert

Accounting for reductions in company tax rates

Background

The *Treasury Laws Amendment (Enterprise Tax Plan) Act 2017* was substantively enacted on 9 May 2017. It was introduced to the House of Representatives on 1 September 2016, was passed with amendments by the Senate on 31 March 2017, finally passed both Houses on 9 May 2017 and received Royal Assent on 19 May 2017. The ATO has called this the Enterprise Tax Plan 2016. Note that this name references the year that the Bill was introduced rather than the year the Act was passed.

Treasury Laws Amendment (Enterprise Tax Plan No.2) Bill 2017 was introduced to the House of Representatives on 11 May 2017 to increase the scope of which corporate entities would be eligible for the lower corporate tax rate in future years. It has not been substantively enacted. The ATO has called this the Enterprise Tax Plan No. 2 2017.

This Alert only relates to the Enterprise Tax Plan 2016 because the legislation for the Enterprise Tax Plan No. 2 2017 appears unlikely to be substantively enacted in the near future.

Tax rates will progressively reduce over a ten-year period for companies with aggregated turnover of less than $50m.

Table of tax rates applying under the Enterprise Tax Plan 2016 amendments:

	Tax rate (%)					
Company type	**2016-17**	**2017-18**	**2018-19 to 2023-24**	**2024-25**	**2025-26**	**2026-27 & later years**
Company with aggregated turnover of up to $10m	27.5	27.5	27.5	27	26	25
Company with aggregated turnover of up to $25	30	27.5	27.5	27	26	25
Company with aggregated turnover of up to $50m	30	30	27.5	27	26	25
All other companies	30	30	30	30	30	30

The tax rate for a company with aggregated turnover of up to $2m was previously reduced from 30% of 28.5% for 2015/16.

The reduced rates under the Enterprise Tax Plan 2016 amendments first apply to the 2016-17 income year. Accordingly, the first income year may already have ended for early balancers (for example, for a December earlier balancer, the reduced rate first applies to the year from 1 January 2016 to 31 December 2016.

Two aspects to the test for eligibility for the lower corporate tax rate are:

1 The company must carry on a business; and

2 The company's "aggregated turnover" is less than the specified threshold for the year.

The aggregated turnover test requires the company to aggregate its turnover with that of entities that are 'connected' or 'affiliated' with it, as defined in the tax law. This will generally include controlled entities, those entities that control the company, and entities that are controlled by the same entity (but, using a 40%+ voting power or right to receive income/capital 'control' threshold) and other entities that act, or could reasonably be expected to act, in accordance with the directions or wishes of the company or in concert with the company.

Annual turnover is defined as all ordinary income earned in the ordinary course of running a business for the income year.

Accounting requirements

Current tax should be measured at the amount expected to be paid to or recovered from the tax authorities by reference to tax rates and laws that have been enacted or substantively enacted by the end of the reporting period (refer AASB 112.46). In Australia, it is generally understood that this is when a tax Bill has passed through both Houses of Parliament (but before Royal Assent).

Deferred tax should be measured by reference to the tax rates and laws, as enacted or substantively enacted by the end of the reporting period, that are expected to apply in the periods in which the assets and liabilities to which the deferred tax relates are realised or settled (refer AASB 112.47).

The test of 'substantive enactment' is applied very strictly. AASB 110 *Events after the Reporting Period* identifies the enactment or announcement of a change in tax rates and laws after the end of the reporting period as an example of a non-adjusting event (refer AASB 110.22(h)). For example, an entity with a reporting period ending on 31 March 2017 issuing its financial statements on 26 May 2017 would measure its tax assets and liabilities by reference to tax rates and laws enacted or substantively enacted as at 31 March 2017 even if the tax rates had changed before 26 May. However, the entity would have to disclose the nature of those changes and provide an estimate of the financial effect of those changes if the impact is expected to be significant (refer AASB 110.21).

Accounting for the change in tax rates

The effect of a change in tax rates on current and/or deferred tax is included as part of income tax expense/(income) in profit or loss except to the extent that it involves a remeasurement of tax originally accounted for in other comprehensive income or in equity, in which case the change should also be dealt with in, respectively, other comprehensive income or directly in equity.

Measuring deferred tax assets and liabilities

Previously, with a single company tax rate of 30%, there was generally no need for a detailed schedule of when deferred tax assets and liabilities are likely to be settled and no need to link this to estimates of company turnover.

There may be a need for a company to:

- determine which entities are 'connected' or 'affiliated' with it;
- determine its aggregated turnover, including those entities that are 'connected' or 'affiliated' with it, in order to determine the tax rate to apply for current tax;
- estimate the periods when deferred tax assets and liabilities are expected to be realised or settled; and
- estimate its aggregated turnover, including those entities that are 'connected' or 'affiliated' with it, in the periods when deferred tax assets and liabilities are expected to be realised or settled in order to determine the tax rate to apply for deferred tax assets and liabilities.

All of these steps will not always be required. For example, if it is obvious that a company has aggregated turnover for 2016/17 of greater than $10m, there will be no need to determine which entities are ‘connected’ or ‘affiliated’ with it in order to calculative its current tax amount. Similarly, if it is obvious that a company is expected to have aggregated turnover for the foreseeable future of greater than $50m, there will be no need to determine which entities are ‘connected’ or ‘affiliated’ with it or to complete detailed scheduling of when deferred tax amounts are expected to be realised or settled in order to calculative its deferred tax assets and liabilities.

Example

A company with say $1m in tax losses (which meet the recognition requirements for a deferred tax asset under AASB 112) will need to assess when these losses are likely to be realised, estimate its aggregated turnover and then apply the correct tax rate as outlined above. If its aggregated turnover was expected to be less than $50m, a deferred tax asset for these losses would be $300,000 at the 30% rate or $275,000 at the 27.5% tax rate and decrease to as low as $250,000 if the 25% rate were to apply. This may result in a material change in the asset for financial reporting purposes.

Conclusion

Since this change in the tax rates for companies with turnover under $50m has been enacted, entities will need to account for the impact of this change in their 30 June 2017 financial statements. This should include consideration of the issues that are summarised above.