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Save franking credits, says CTA

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Big companies have described the costs associated with lowering the corporate tax rate as "modest" and suggested legislation to enact the change be rewritten to shield shareholders from a drop in the value of franking credits.

Draft laws make it clear that as the company tax rate is stepped down over a decade, dividends will be franked at lower rates even if tax was paid by the company at 30 per cent.

As such, some of the losses associated with a lower corporate tax income for the government will be offset by the fact that shareholders will pay more tax.

Modelling for Treasury estimates this direct gain in personal income tax and superannuation income tax collections at $3.1 billion.

The Corporate Tax Association, which represents the nation's biggest corporate taxpayers, says tax credits should be franked at the rate at which they were accrued.

"In our view, a better way to manage the tax rate reduction in such circumstance is to continue to allow corporates the ability to frank their dividends to the 30 per cent rate until such time as its 30 per cent franking credit balance is fully utilised," CTA says in a submission to the Senate Standing Committee on Economics.

"This could possibly be managed by quarantining a 30 per cent franking account and the establishment of other franking accounts that could trace tax paid to the respective income year."

Because of the implications for franking credits, it is anticipated companies would come under more pressure from shareholders to disgorge credits ahead of any tax rate reduction.

Key points

Tax credits should be franked at the rate at which they were accrued.

The impact of the enterprise tax plan is modest

The Turnbull government's "enterprise tax plan" was announced in the May federal budget.

Companies with turnover of $10 million or less will pay tax at 27.5 per cent from 2016-17. Each year more companies will be brought on to the lower rate until all companies are included regardless of size in 2022-23.

The rate will then step down to 27 per cent in 2024-25, and by one percentage point in each subsequent year until it reaches 25 per cent in 2026-27.

At an estimated cost of $48 billion over a decade, "the impact of the enterprise tax plan on the budget bottom line is modest", the CTA submission also says.

During the election campaign, Prime Minister Malcolm Turnbull promised to legislate for the whole 10 years of tax cuts at once. But the plan is unlikely to garner enough support to make it through Parliament.

Once it is rejected, the government is expected to try again by hiving off the first stage or stages of the plan, which benefit smaller businesses. Labor has said it is only willing to support tax cuts for businesses with turnover under $2 million.

In its submission, Pitcher Partners says the government should help small and medium businesses through what will be a rapid transition.

"The bill proposes that the corporate tax rate reduction and the associated impact on imputation will be retrospective for small and medium-sized corporate taxpayers, as many will transition at 1 July 2016 without appropriate warning," the submission says.

"As such, many small and medium-sized companies will be unable to minimise the impact of the new measures on their franking account balances."

Pitcher Partners recommends an option similar to that proposed by the CTA.

"The provisions should allow after-tax profits that existed at a company's transition time ... to be franked at the 30 per cent rate – reflecting the rate of tax which the company paid on the profits – rather than the lower imputation rate," it says.