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The Treasury
Langton Crescent
PARKES ACT 2600

By email: prebudgetsubs@treasury.gov.au

Dear Sir/Madam

2021-22 PRE-BUDGET SUBMISSION

A. INTRODUCTION

1. We write in response to the media release issued on 27 November 2020 by Senator the Hon Michael Sukkar, Minister for Housing and Assistant Treasurer, inviting submissions on priorities for the 2021-22 Budget ("**Media Release**").

2. Pitcher Partners specialises in advising clients in what is commonly referred to as the middle market. The middle market is a diverse group of taxpayers comprising of privately-owned entities and their owners, regardless of their size. Accordingly, the middle market covers a broad spectrum of entities and individuals, ranging from closely held listed companies to family operated businesses.

3. In our pre-2020 budget submissions to the Treasury on 19 December 2019 and again on 24 August 2020, we outlined three important areas that we believed the Government needed to focus on to support SMEs' growth, their businesses and to support the creation of jobs. This included a focus on (1) increasing the competitive capacity of Australian business through investments in science, education and innovation; (2) funding critical longer-term infrastructure projects; and (3) reducing compliance costs for the middle market and ordinary salary and wage earners by way of significant simplification of the tax system.

4. While we still believe these three areas are of critical importance to Australia's economy in the longer term, the challenges of COVID-19 still require a change in the focus of the Budget.

5. The impact of COVID-19 has been significant for many businesses in the middle market. Many of the Government's initiatives (such as the Cash Flow Boost, the JobKeeper and JobMaker regimes and temporary full expensing) have provided much needed assistance for businesses to aid their survival during this period and has helped to encourage spending on business investments assets. However, there is substantial concern in the middle market about the uncertainty of the future for business taxpayers once these stimulus measures cease to have affect. In particular, there is a concern that these measures will not lead to job growth in the future periods.

6. Transitioning the economy cannot be achieved straight away. To facilitate longer term growth, we acknowledge that the Government will need to re-assess the systemic nature of our taxation system. However, such a review could take some time (which may be too late). Accordingly, the Government must be able to introduce policies in the short term that will have a meaningful impact on business and employment.

B. TAX LAW PROPOSALS

Corporate tax rate reduction

7. We believe that one simple change, being a reduction in the corporate tax rate, could provide additional cash to small business that would assist working capital needs. A corporate tax rate reduction is a very effective measure in promoting business expenditure. This is because a corporate tax rate reduction is coupled with a reduction in the franking credits that attach to dividends. This means that, if the profits are paid to the owners, the owners will generally pay significant top-up tax. However, if the profits are used for business purposes (such as for the payment of wages or for acquiring new assets), the payments result in further tax deductions. Accordingly, a reduction in tax rate for corporate taxpayers implicitly should result in an increase in business spending.

8. We therefore would encourage the Government to consider:

   8.1. Bringing forward the planned reduction in the corporate tax rate for base rate entities to 25% so that it applies for the 2020/21 income year.

   8.2. Further reducing the corporate tax rate for base rate entities to 20% for the 2021/22 income year ("**small business special tax rate**").

   8.3. Whether the small business special tax rate be limited to relatively more active base rate entities (e.g. by reducing the base rate entity passive income threshold from 80% to, say 60% of assessable income).

   8.4. Placing a cap on the total franking credit benefits that a base rate entity may pass out to its shareholders. Together with the impact of the change in the applicable gross up rate, this would provide a disincentive for base rate entities to pay out the cash savings as dividends.

9. We acknowledge this policy could encourage a greater use of Division 7A compliant loans ("section 109N loans") that require a repayment over seven years. This would not be consistent with our policy suggestion and would defeat the purpose of the policy (i.e. by allow corporate profits to be lent to individuals for private purposes).

10. To counter that, we would suggest that consideration be given to restricting the extent to which base rate entities can increase their section 109N loans (i.e. loans made over a 7 year period). For example, 109N loans could be limited to those that are made to other entities where the money is used by that

entity for business purposes only[1]. We understand that this could add to the complexity of the provisions, however we believe that this additional integrity would help the proposed amendment achieve its policy intent.

11. Although we would encourage the Government to consider making a permanent change for small business taxpayers, we note that these changes would not have to be permanent. Instead, they could be introduced on a temporary basis, to allow a reduction of costs for businesses during the transitional recovery period post COVID-19. We believe that this would encourage reinvestment of earnings into the business, as income withdrawn from the business (i.e. by way of dividends) would still be subjected to “top up” tax at the shareholder level.

12. We highlight that our proposal is broadly in line with the corporate tax rate policies offered in other jurisdictions such as the United Kingdom, that provides for a small profits tax rate of 19%. The United States also provides for a corporate tax rate of 21%.

We would be more than happy to discuss any aspect of this submission with you and provide you further thoughts on any of our recommendations. Please contact Alexis Kokkinos on (03) 8610 5170 at any time to discuss.

Yours sincerely

A M KOKKINOS

Executive Director

[1] All other loans would need to be repaid by company’s lodgement date. Generally, where the borrower does not have the requisite cash to repay the loan, a repayment would occur via a franked dividend. This would ensure that top-up tax is payable by the borrower (providing integrity to the lower corporate tax rate for small business taxpayers).