

Dear Simon

This email follows our phone discussion concerning the draft legislation and draft explanatory memorandum for new law to delineate companies eligible for the 27.5% tax rate.

We applaud the intent to resolve the disparity between an operating subsidiary and a holding company using the notion of non-portfolio dividends (treated as not passive income) and indeed the intent to bring certainty to this broader and currently murky delineation requirement.

However, we think there is an unintended outcome in the draft in the circumstance where a holding company holds some cash (might be from prior year operating company dividends) and, in a particular financial year, does not receive operating company dividends. In that case, the holding company would have small interest income but no non-portfolio dividends and would, for that year, be subject to a 30% tax rate whereas it might have been subject to the lower rate in previous or indeed future income years. That would make the whole franking and dividend imputation circumstance somewhat confusing.

Our suggestion is to consider the legal reasoning in tax ruling MT 2006/1, from para 191, which analyses case law as to the "business of being a holding company". Under that analysis, a holding company is in business if it does more than merely own, derived dividends from and control the subsidiaries. If it loans funds, guarantees loans or provides other services to the subsidiaries, then it is in business (the business of being a holding company). Although that ruling is in relation to the GST system, the logic seems appropriate to consider for the drafting of this new amendment.

Trust that helps.

Andrew Lovett