Australian Government

The Treasury

COSTING MINUTE

Date: 16/11/2009
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File:

To: **Shane Johnson, Australia's Future Tax System**

Cc: **Katherine Tuck, Australia's Future Tax System**

TITLE **AFTS Proposal - loss carry-back for companies**

SUMMARY OF PROPOSAL

Intent of the proposal

Under the current tax system, the government collects a share of a businesses gain, but does not always contribute its share of expenses where a business makes a loss. This restriction discourages risk taking and entrepreneurial activity.

Current taxation treatment/problem

Where company incurs a loss it can be carried forward and used against future taxable income subject to the continuity of ownership and same business tests. These provisions limit loss utilisation which may discourage risky investment.

Proposed taxation treatment

Loss arrangements can be improved by allowing a one year carry back for revenue losses. Under the carry back, businesses would be able to offset losses made in a particular income year against taxable income from the preceding year.

This option allows taxpayers to receive an immediate tax refund to the extent the business paid tax in the previous year. Without this, the timing of the income year can lead to over taxation as it does not consider expenditure that falls narrowly outside the income year.

As taxpayers can time the realization of capital losses, it is recommended that the proposed carry-back be restricted to revenue losses.

Further, due to Australia's imputation system, provisions would also be introduced to prevent losses from being offset against prior year tax payments that have been distributed to shareholders as imputation credits. To address this, the carry-back arrangements would be limited to the companies franking account balance. This would limit the effectiveness of the measure to some extent but is a necessary integrity safeguard.

ELEMENTS AND OPTIONS

Elements

Element ID	Description
A	Allow a one year carry back for revenue losses.

Options examined

Option ID	Option	Assumed start date	Was a Departmental Impact Assessment sought?	Was a Tax Regulation Impact (preliminary assessment) sought?
1	A	01/07/2010	No	No

FINANCIAL IMPLICATIONS

IMPACT ON FISCAL BALANCE - ACCRUAL-BUDGET ($m)

Option ID	Year of Maturity	2009-10	2010-11	2011-12	2012-13	2013-14
1	2020-21	-	-	-520	-440	-380

- Nil

IMPACT ON UNDERLYING CASH BALANCE ($m)

Option ID	Year of Maturity	2009-10	2010-11	2011-12	2012-13	2013-14
1	2020-21	-	-	-520	-440	-380

- Nil

The costing of each option has been undertaken independently from those of other options, meaning that the costs are not necessarily additive.

RELIABILITY

The estimate is based on tax data, but is heavily reliant on the underlying assumptions. It can be considered to have a medium level of reliability.

COSTING DETAILS

Methodology

Current year losses were micro simulated against the average of three prior years taxable income to determine a 3 year average base revenue impact for the proposal. The losses were limited by franking balance and by the companies taxable status.

The base revenue impact was grown and adjusted for the new company tax rate. Clawback was applied for the utilisation of losses in future years.

- This Option is expected to mature in 2020-21. The first year of maturity is expected to have a revenue loss of around $140m in 2010-11 dollars.

Data

Company tax return forms over three years 2004-05, 2005-06 and 2006-07.

Assumptions

It is assumed losses would have been utilised in future years according to the Table 1 with 5% used each subsequent year after the 5 year period.

90% of losses would eventually be utilised.

0% timing within year, 100% timing out of year.

Company tax rate 30% until 2009-10, 25% from 1 July 2010 onwards, as requested by Treasury.

The growth rates in table 2 were applied, based on Treasury parameters:

No behavioural impact has been included in this estimate.

Losses able to be utilised were reduced in future years for the unlimited loss carry back option, due to prior year tax being utilised. The reduction is outlined in table 3. This represents the total reduction for each year, not an addative per year reduction.

Table 1: Loss utilisation

Loss utilisation profile	Year + 1	Year + 2	Year + 3	Year + 4	Year + 5
When losses would have otherwise been utilised	20%	15%	15%	10%	5%

Table 2: Losses growth

IncomeYear	07-08	08-09	09-10	10-11	11-12	12-13 onward
Growth	8.94%	6.41%	-11.20%	4.73%	7.00%	7.25%

Table 3: Reduction in losses able to be utilised due to reduced tax base

Loss utilisation profile	Year + 1	Year + 2	Year + 3	Year + 4	Year + 5
Reduction in losses utilised	30%	45%	50%	55%	60%

ADDITIONAL INFORMATION

Departmental impacts

An assessment of the Departmental Impact has not been requested.

Tax Regulation Impact (preliminary assessment)

A preliminary assessment of the Tax Regulation Impact has not been requested.

All material provided in this minute must be cleared by the Tax Analysis Division incorporated into Executive Minutes, Cabinet Submissions, any other briefing material, or when used for external purposes.

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