The Senate

Economics
Legislation Committee

Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016 [Provisions]

October 2016

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ISBN 978-1-76010-456-6

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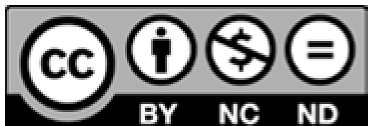

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Printed by the Senate Printing Unit, Parliament House, Canberra.

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Chapter 1

Introduction and overview of the bill

1.1 On 15 September 2016, the Senate referred the provisions of the Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016 (the bill) to the Senate Economics Legislation Committee for inquiry and report by 10 October 2016.

1.2 The bill makes a number of amendments to tax legislation to implement the government's 2016–17 Budget commitment to progressively reduce company tax rates for small and large companies over the next decade—the 'Ten Year Enterprise Tax Plan'. The measures in the bill include:

- an immediate reduction in the corporate tax rate to 27.5 per cent for the 2016–17 tax year for small businesses—that is, corporate tax entities with an aggregated turnover of less than $10 million;
- a progressive extension of the above reduction in the corporate tax rate to all corporate tax entities by the 2023–24 income year, and in turn progressive reductions in the corporate tax rate to 25 per cent from 2026–27;
- consequential amendments to the dividend imputation arrangements to adjust imputation credits as the company tax rate changes;
- a progressive increase in the tax discount for unincorporated small businesses that is equivalent to the above reductions in the corporate tax rate; and
- an increase in the aggregated turnover threshold for access to small business tax concessions from $2 million to $10 million.

1.3 In his second reading speech, the Treasurer, the Hon Scott Morrison MP, explained that the bill:

> …forms a key component of the government's reform agenda to improve Australia's tax system for businesses and to drive investment in our economy as it transitions from the investment phase of the mining boom, as it is successfully doing, to broader based growth.[1]

Conduct of the inquiry

1.4 The committee advertised the inquiry on its website and social media, and wrote directly to a range of individuals and organisations inviting written submissions by 23 September 2016. The committee received 29 submissions, which are listed at Appendix 1. The committee thanks all groups and individuals who took the time to make a written submission.

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1 The Hon Scott Morrison MP, second reading speech, *House of Representatives Hansard*, 1 September 2016, p. 11.

1.5 The committee did not hold any public hearings for this inquiry.

Overview of the bill

Reducing the corporate tax rate

1.6 Schedule 1 to the bill amends the *Income Tax Rates Act 1986* (ITAA 1986) to reduce the corporate tax rate to 27.5 per cent for the 2016–17 income tax year for corporate tax entities that are small businesses—that is, corporate tax entities with an aggregated turnover of less than $10 million.

1.7 The bill also progressively extends the lower corporate tax rate to all corporate tax entities by 2023–24. The rate will then be cut to:

- 27 per cent for the 2024–25 income year;
- 26 per cent for the 2025–26 income year; and
- 25 per cent for the 2026–27 income year and later income years.

1.8 The progressive reductions in the corporate tax rate, and the extension of the lower tax rates to all corporate tax entities, is shown below in Table 1.

Table 1: Summary of changes to the corporate tax rate

Income year	*Turnover threshold*	*Tax rate for companies under threshold (%)*	*General corporate tax rate (%)*
2015–16	$2 million	28.5	30
2016–17	$10 million	27.5	30
2017–18	$25 million	27.5	30
2018–19	$50 million	27.5	30
2019–20	$100 million	27.5	30
2020–21	$250 million	27.5	30
2021–22	$500 million	27.5	30
2022–23	$1 billion	27.5	30
2023–24	*Threshold removed*	27.5	
2024–25	n/a	27	
2025–26	n/a	26	
2026–27	n/a	25	

Source: Table based on information in Explanatory Memorandum, p. 11.

1.9 The Explanatory Memorandum explains that Australia's corporate tax rate is currently one of the highest in the world and significantly above the OECD average. The reductions in the bill will encourage investment, economic growth and job creation, and 'make Australian companies more internationally competitive in a tough global market place'.[2] The Explanatory Memorandum further suggests this will 'result in higher living standards for Australians and an expected permanent increase in the size of the economy of just over one per cent in the long term'.[3]

Operation of the imputation system

1.10 Under Australia's dividends imputation system, where a corporate tax entity distributes profits to its members, and where income tax has already been paid on those profits—such as when a company pays a dividend to its shareholders—they have the option of passing on, on 'imputing', credits for the tax. This is known as 'franking' the distribution, and franking credits are attached to the distribution and can be used by the recipients as tax offsets. As the Australian Tax Office explains:

> Although the recipients are taxed on the full amount of the profit represented by the distribution and the attached franking credits, they are allowed a credit for the tax already paid by the corporate tax entity.
>
> This prevents double taxation – that is, the taxation of profits when earned by a corporate tax entity, and again when a recipient receives a distribution.[4]

1.11 Currently, the maximum franking credit that can be allocated to a frankable distribution is based on the headline corporate tax rate of 30 per cent for all corporate tax entities. For the purpose of aligning the franking rate with the proposed reductions in the corporate tax rate and the gradual extension of the lower rate to all corporate entities, schedule 4 of the bill provides for a 'corporate tax rate for imputation purposes'. This is generally defined to mean the entity's corporate tax rate for the current income year, but worked out on the assumption that the entity's aggregated turnover for the income year is equal to its aggregated turnover for the previous income year.[5] As the Explanatory Memorandum explains:

> …from the 2016–17 income year, the operation of the imputation system for corporate tax entities will be based on the company's corporate tax rate for a particular income year, worked out having regard to the entity's aggregated turnover for the previous income year. This is necessary because corporate tax entities usually pay distributions to members for an income year during that income year. However, a corporate tax entity will not know

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2 Explanatory Memorandum, *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016* (hereafter 'Explanatory Memorandum'), p. 10.

3 Explanatory Memorandum, p. 10.

4 ATO, 'Imputation', https://www.ato.gov.au/Business/Imputation/, accessed 4 October 2016.

5 Explanatory Memorandum, p. 25.

its aggregated turnover for a particular income year (and therefore its corporate tax rate for that income year) until after the end of the income year.[6]

Increase to the tax discount for unincorporated small businesses

1.12 The small business income tax offset was introduced in 2015–16 as part of a range of tax measures intended to help small business. It entitles individuals who are small business entities, or who are liable to pay income tax on a share of the income of a small business entity, to a tax offset equal to 5 per cent of their basic income liability that relates to their total net small business income, capped at $1000.[7]

1.13 The offset was introduced to provide unincorporated small businesses with a tax discount broadly equivalent to the 1.5 per cent reduction in the small business company tax rate introduced in 2015–16. For the same reason, the current bill increases the offset rate alongside decreases in the corporate tax rate, and thereby 'minimises tax distortions between the different entity types through which small businesses may be run, and ensures that the many small businesses run through unincorporated entities also receive an increase in their cash flow'.[8]

1.14 Specifically, schedule 2 to the bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to increase the small business income tax offset to 16 per cent of net small business income by the 2026–27 income year. As set out in the Explanatory Memorandum, the rate of the offset will rise from 5 per cent in 2015–16 to 16 per cent in 2026–27 as follows:

- For the 2016–17 to 2023–24 income years, the offset is 8 per cent of net small business income.
- For the 2024–25 income year, the offset is 10 per cent of net small business income.
- For the 2025–26 income year, the offset is 13 per cent of net small business income.[9]

1.15 These changes will help address the fact that reductions to the corporate tax rate do not provide a tax cut for those businesses that are not operated through a company. There are approximately 2.3 million businesses—accounting for around 70 per cent of small businesses—in this category.[10]

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6 Explanatory Memorandum, p. 24.

7 Explanatory Memorandum, p. 35.

8 Explanatory Memorandum, p. 36.

9 Explanatory Memorandum, p. 4.

10 Explanatory Memorandum, p. 5.

Increase to the small business entity threshold

1.16 Schedule 3 to the bill amends the ITAA 1997 to increase the aggregated turnover threshold for access to certain small business tax concessions from $2 million to $10 million. The Explanatory Memorandum explains that the aggregated turnover threshold for access to the small business income tax offset will be limited to $5 million, and the current $2 million threshold will be retained for the small business capital gains tax concessions.

1.17 According to the Explanatory Memorandum, the increase in the aggregated turnover threshold will 'allow an additional 90 000 to 100 000 businesses to access the benefits of the small business tax concessions'.[11]

Financial impact

1.18 The revenue implications of the amendments over the forward estimates period is set out in below in Table 2.[12]

Table 2: Financial impact (as set out in Explanatory Memorandum)

2016–17	***2017–18***	***2018–19***	***2019–20***
-$400m	-$500m	-$800m	-$950m

11 Explanatory Memorandum, p. 7.

12 Explanatory Memorandum, p. 3.

Chapter 2

Views on the bill

2.1 The committee received 29 written submissions. This chapter provides an overview of the views expressed in these submissions.

2.2 An overwhelming majority of submissions expressed support for the bill. One of the key arguments made in support of the bill was that it would help make Australia's corporate tax settings more internationally competitive and encourage higher levels of foreign investment in Australia. Others also argued that the bill would help reverse declining levels of business investment generally. Greater investment, it was argued, would flow through to stronger economic growth, more jobs and higher wages for Australian workers.

2.3 Other submissions highlighted the benefits of the Enterprise Tax Plan for small and medium businesses specifically. At the same time, a number of submissions emphasised the importance of passing the bill in its entirety and ensuring the tax cuts were ultimately extended to all businesses, large and small.

2.4 The committee also received some submissions arguing against the bill, on the grounds it would lead to lower government revenue without necessarily delivering the promised economic benefits. Some critics also suggested that the primary beneficiaries of the bill would be foreign investors and, because of the way the United States foreign tax credit system operated, the US government. These criticisms are set out in this chapter, along with responses from supporters of the bill.

Support for the Enterprise Tax Plan

Need for internationally competitive corporate tax settings

2.5 Many submitters argued that Australia has comparatively high corporate tax rates, and submitted that the tax cuts set out in the bill were necessary to ensure Australia remained internationally competitive. For example, the Financial Services Council (FSC) emphasised the importance of company tax rate settings given intensifying competition for foreign investment and the increasing mobility of businesses. Australia's current company tax rate of 30 per cent, it submitted, compared poorly to the average in Asia of 22 per cent. The FSC added:

> Research demonstrates cutting company tax will drive capital into Australia for new enterprises, jobs and opportunities. Workers will be a substantial beneficiary of increased investment in Australia as increased labour productivity spurred by this investment will result in higher real wages.[1]

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1 Financial Services Council, *Submission 1*, p.1.

2.6 The Business Council of Australia (BCA) also argued that Australia was 'falling behind in the global contest for new investment'.[2] It pointed to evidence that overseas investment in Australia had fallen 45 per cent in the last year, and was currently at its lowest level since 2003. While some of this fall might be attributed to the winding down of the mining investment boom, the BCA noted that other resource-exporting economies (for example, Brazil and Canada) had experienced much smaller declines in overseas investment.[3] Falling foreign investment was particularly problematic, the BCA argued, because Australia was a small, open economy that relied heavily on foreign investment to boost its own investment capacity and grow the economy.[4] According to the BCA, with other countries continuing to cut corporate tax rates while Australia stood still, if the bill was not passed Australia's 'company tax rate will become even more uncompetitive, driving investment, innovation and jobs abroad'.[5]

2.7 The Business Coalition for Tax Reform (BCTR) also noted that Australia's company tax rate had become less and less competitive compared to other OECD countries. It submitted:

> In an environment where global investment is mobile and highly sensitive to balancing risk and reward, and Australia's recent mining construction boom has not yet been replaced by other major sources of investment, we cannot afford to ignore the ongoing deterioration of our global competitive position.[6]

2.8 The Centre for Independent Studies (CIS) produced evidence showing that when international comparisons took into account country size, Australia was even less competitive with other OECD economies.[7] Noting that investment decisions are often made over a long-term horizon, the CIS also noted that 32 of 35 OECD countries had in fact cut their overall company tax rate since Australia last cut its rate, suggesting that Australia was falling further behind.[8]

2.9 In addition to arguing that Australia's comparatively high corporate tax rate discouraged international investment, the CIS also warned that Australian companies might eventually seek to relocate to countries with more competitive tax settings. This, it contended, could have a major impact on tax revenues. The largest companies in Australia, the CIS submitted:

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2 Business Council of Australia, *Submission 20*, p. 2.

3 Business Council of Australia, *Submission 20*, p. 5.

4 Business Council of Australia, *Submission 20*, p. 4.

5 Business Council of Australia, *Submission 20*, p. 7.

6 Business Coalition for Tax Reform, *Submission 9*, p. 1.

7 The Centre for Independent Studies, *Submission 13*, pp. 5–6.

8 The Centre for Independent Studies, *Submission 13*, p. 6.

> …may have no alternative but to be located in Australia for the moment, but there is a risk that one or more of these companies may be driven to relocate offshore if the gap to other tax rates becomes too great.[9]

2.10 A range of other submitters, including the Minerals Council of Australia (MCA), Australian Institute of Company Directors, CPA Australia, the Corporate Tax Association (CTA), KPMG, PwC, the Australian Financial Markets Association (AFMA), Business SA, the Australian Chamber of Commerce and Industry (ACCI) and the Chamber of Commerce and Industry Queensland (CCIQ) also argued that Australia's current corporate tax rate was internationally uncompetitive.[10]

Need to address falling levels of business investment

2.11 A number of submitters also argued the Enterprise Tax Plan would drive higher levels of business investment, and emphasised the need for stronger business investment in the current economic environment. For example, Ai Group argued:

> In our view, raising business investment is a leading priority in the current environment in which the Australian economy requires rebalancing in the wake of the mining investment boom. In particular, this rebalancing requires the rejuvenation and re-capitalisation of the non-mining trade exposed sectors that were so adversely impacted by the period of high currency closely associated with the commodity price boom.[11]

2.12 The BCA also expressed concern about the impact of falling levels of business investment. It submitted that current economic activity was being driven by past investments rather than new investment; current levels of business investment, the BCA further noted, were falling at a rate last seen in the early 1990s recession.[12]

2.13 Arguing that business investment 'is a core driver of economic growth and prosperity', the BCA made the case that the tax cuts would be important in helping to arrest and reverse falling business investment levels in Australia. It acknowledged that tax was not the only factor in driving business investment, 'but a globally-competitive company tax rate is one of the most direct and effective economy-wide policy levers that we have for driving higher investment'.[13]

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9 The Centre for Independent Studies, *Submission 13*, p. 2.

10 Minerals Council of Australia, *Submission 17*, p. 3; Australian Institute of Company Directors, *Submission 22*, p. 2; CPA Australia, *Submission 3*, p. 1; Corporate Tax Association, *Submission 8*, p. 2; KPMG, *Submission 7*, pp. 9–10; PricewaterhouseCoopers, *Submission 16*, pp. 1–2; Australian Financial Markets Association, *Submission 18*, p. 1; Business SA, *Submission 19*, p. 1; Australian Chamber of Commerce and Industry, *Submission 12*, p. 6; Chamber of Commerce and Industry Queensland, *Submission 2*, p. 1.

11 Ai Group, *Submission 24*, p. 3.

12 Business Council of Australia, *Submission 20*, p. 4.

13 Business Council of Australia, *Submission 20*, p. 2.

2.14 The BCA also reasoned that the benefits of the tax cuts would start to be apparent ahead of the full implementation of the actual cuts in ten years' time:

> Larger businesses will bring forward investments ahead of actual tax cuts if they are confident that the lower rates will apply once investments come on stream. Signalling credible future tax cuts can bring forward the economic benefits for the whole community.[14]

2.15 Like the BCA, the CIS noted that non-mining investment is 'at recessionary levels: historically, it has only been this low in the depths of the 1990s recession'.[15] The CIS provided an extensive list of sources that argued that reducing corporate tax rates helps boost business investment.[16]

Enterprise Tax Plan as a driver of growth in the economy, employment and wages

2.16 Another argument made by multiple submitters was that reductions in the corporate tax rate would help promote economic activity, jobs growth and increased prosperity for Australian workers. For instance, CPA Australia argued that there was clear evidence:

> …that reducing the tax burden on businesses lifts productivity, and increases both their competitiveness and their capacity to expand, and encourages job creation. Further, the tax incidence of higher company taxes falls on workers as lower wages, and less jobs.[17]

2.17 The CTA advised that it was 'fully supportive' of the corporate tax rate reduction. It noted that the 1 per cent permanent increase to Gross Domestic Product (GDP) over the long-term would be equivalent to a $16.7 billion increase in the size of the economy at current GDP levels, and should in fact be larger by 2026 when the rate reduction was fully implemented. A larger economy, the CTA argued, would ultimately lead to higher wages for Australian workers.[18]

2.18 The BCA argued that the benefits of the tax cuts would be widely shared, and took aim at the idea the cuts were an expression of 'trickle down' economics:

> Australian workers will be the biggest winners—not foreign shareholders, not the banks, not other big businesses. Australian workers receive around two-thirds of the total gains because higher investment means more jobs and higher wages.[19]

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14 Business Council of Australia, *Submission 20*, p. 12.

15 The Centre for Independent Studies, *Submission 13*, p. 15.

16 The Centre for Independent Studies, *Submission 13*, pp. 16–17.

17 CPA Australia, *Submission 3*, p. 1.

18 Corporate Tax Association, *Submission 8*, p. 2.

19 Business Council of Australia, *Submission 20*, p. 3.

2.19 The CIS also suggested that the tax cuts would help address prevailing low levels of wages growth:

> The improvement to wages occurs because the tax cut results in more capital being invested in Australia… This makes the economy larger, and a larger economy results in increased wages. Another way of explaining this is the increase in capital in the economy means there is more capital per worker. Each worker becomes more productive as a result. The increased productivity of each worker raises the wages paid to workers.[20]

2.20 The BCTR also argued that the primary beneficiaries of the tax cuts would, in fact, be Australian workers:

> In terms of the benefits, there is a strong consensus among economists that reducing our corporate rate will lead to higher levels of investment over the long-term and generate significant additional economic growth. Since as much as two-thirds of company tax is shifted to labour, mainly through lower wages, the main beneficiaries of a company tax cut will be wage earners.[21]

2.21 The CCIQ argued that reductions in the corporate tax rate would help encourage greater foreign investment, and in turn 'increased labour productivity resulting in higher wages and increased workforce participation'.[22]

Benefits for small and medium businesses

2.22 Some submissions highlighted the benefits of the Enterprise Tax Plan for small and medium enterprises (SMEs). Ai Group emphasised that small businesses would benefit from the whole package of measures in the bill—including lifting the threshold below which businesses qualify for small business entity treatment for tax purposes; applying a 27.5 per cent tax rate to incorporated small business entities; and raising the discount for unincorporated small business entity income to 8 per cent. Ai Group concluded:

> Regardless of the form of business entity involved, these measures will improve the incentives for small business owners to invest in their businesses, to grow and to lift the numbers of people they employ. Raising the small business entity threshold will also reduce compliance costs for close to 100,000 small-to-medium sized businesses.[23]

2.23 Similarly, the Institute of Public Accountants (IPA) underlined the important contribution of small businesses to productivity and economic growth, and welcomed the proposed increases to the turnover threshold for small business entities:

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20 The Centre for Independent Studies, *Submission 13*, p. 18.

21 Business Coalition for Tax Reform, *Submission 9*, p. 2.

22 Chamber of Commerce and Industry Queensland, *Submission 2*, p. 2.

23 Ai Group, *Submission 24*, p. 3.

> We agree with the Government that providing more tax relief to SMEs will generate a growth dividend to the economy in the form of potentially increased employment, higher wages and removing disincentives to business growth caused by the turnover threshold. The current low threshold discourages growth as entities lose access to tax concessions once they pass the threshold.[24]

2.24 In its submission, the IPA noted that an estimated 90 000 to 100 000 businesses would benefit from lifting aggregated turnover threshold for access to small business tax concessions from $2 million to $10 million:

> This would enable greater reinvestment in small businesses and provide the opportunity for these businesses to increase employment and increase wages. It would also provide incentives for small businesses at or near the existing $2 million turnover threshold to grow, as currently they would lose these concessions once they passed the threshold.
>
> Of particular interest to entities with turnover above the existing threshold limit is access to simpler depreciation rules, lower corporate tax rate and also the newly enacted small business roll-over restructure relief.[25]

2.25 The IPA also wrote in support of increasing the tax discount for unincorporated small businesses:

> Given further cuts to the small business company tax rate, it is entirely appropriate that further increases to the tax discount provided by the offset are made. This minimises tax distortions between the different entity types through which small businesses may be run, and ensures that the many small businesses run through unincorporated entities also receive an increase in their cash flow from tax relief.[26]

2.26 The Australian Small Business and Family Enterprise Ombudsman, Ms Kate Carnell AO, also expressed support for increasing the tax discount for unincorporated small businesses:

> This would account for the approximately 73 per cent of small businesses, particularly small family businesses, that choose to manage their affairs through various legal structures such as partnerships and trusts. Offering a tax discount for unincorporated small businesses in conjunction with lowering the corporate tax rate for small businesses ensures sole traders, partnerships and trusts receive a similar tax benefit to incorporated small businesses.[27]

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24 Institute of Public Accountants, *Submission 11*, p. 3.

25 Institute of Public Accountants, *Submission 11*, pp. 4–5.

26 Institute of Public Accountants, *Submission 11*, p. 6.

27 Australian Small Business and Family Enterprise Ombudsman, *Submission 28*, p 2.

2.27 Ms Carnell also registered support for the proposed expansion of the small business entity threshold for tax purposes, suggesting the higher threshold:

> …would allow more small businesses, including family businesses, to access these red-tape saving measures. Changes to definitions and eligibility criteria which support as many small businesses as possible to access these reform measures, will help them to reinvest much-needed funds back into the business.[28]

Importance of extending the tax cuts to all businesses

2.28 While submitters generally welcomed the cuts for small businesses, some also emphasised the importance of ultimately extending the tax cuts to all businesses, as currently provided for in the bill. In this connection, submitters cautioned against any move to amend the bill to restrict the tax cuts so that they were only available for smaller businesses. For example, the BCA submitted:

> Restricting the tax cuts to smaller businesses would mean missing out on the bulk of the investment gains and barely improve our global competitiveness.[29]

2.29 The BCA added that restricting the tax cuts to small businesses would lock in a two-tier company tax system and 'entrench perverse incentives for businesses to inefficiently structure their businesses for tax purposes'. In addition, the BCA suggested that small businesses would also benefit from across-the-board cuts, given the improved economic conditions the cuts would produce and the reliance of small and large businesses on one another.[30]

2.30 The BCTR also argued against any moves to amend the bill in this regard:

> The notion of amending the bill so that tax cuts are denied to larger businesses, even in ten years' time, raises the alarming prospect of Australia's international competitiveness being even further eroded, with serious consequences for future investment, jobs and wages. As a smaller capital-importing country, we cannot afford not to set out on this modest path to maintaining our competitiveness and our ability to attract much-needed capital investment.[31]

2.31 The MCA, while suggesting the staged reduction in the corporate tax rate was fiscally responsible, also emphasised the importance of extending the cuts to all corporate entities:

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28 Australian Small Business and Family Enterprise Ombudsman, *Submission 28*, p. 2.

29 Business Council of Australia, *Submission 20*, p. 3.

30 Business Council of Australia, *Submission 20*, p. 3.

31 Business Coalition for Tax Reform, *Submission 9*, pp. 1–2.

> Importantly the proposed rate cut should apply to all corporates, small and large, to bring the company tax rate back into alignment over time. Different tax rates based on business size or turnover introduce distortions and complexity into the tax system. Any alternative to an economy wide corporate tax cut is a second best option and would not have the same impact on Australia's competiveness.[32]

2.32 The ACCI, which noted that most of its own members were small businesses, also cautioned against any amendments that would deny the tax cuts to larger businesses. In addition to undermining the benefits to the economy of the Enterprise Tax Plan, the ACCI argued, any such amendment:

> …risks entrenching a two-tier company tax system, which gives businesses an incentive to restructure or turn down growth opportunities because the effective tax rate from moving above the threshold becomes so high.[33]

Opposition to the bill and counterarguments from supporters of the bill

2.33 Several submitters argued against the bill, in large measure on the grounds that the tax cuts would result in a loss of revenue that the government needed to fund spending on health, education, reducing inequality and other policy measures. Some of these submitters also suggested that the bill would primarily benefit wealthy individuals and companies, rather than low and middle income Australians.

2.34 This section of the report sets out concerns expressed in submissions and competing perspectives on these concerns as set out by supporters of the bill.

Concerns regarding the effect of corporate tax cuts on government revenue

2.35 Some submitters argued that the tax cuts imposed too high a cost on government revenue. For example, the Australian Council of Social Services (ACOSS) opposed the bill, on the basis that the lost revenue would have to be replaced from other sources such as personal income tax increases or spending cuts. ACOSS contended that the proposed tax cuts contrasted with unlegislated measures that would cut $7 billion over the next four years from social security payments.[34]

2.36 Similarly, the Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia (JIMU, Uniting Church), argued that government revenue was already too low for the government to deliver 'basic

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32 Minerals Council of Australia, *Submission 17*, p. 11.

33 Australian Chamber of Commerce and Industry, *Submission 12*, p. 6.

34 Australian Council of Social Service (ACOSS), *Submission 6*, p. 1.

functions in protecting vulnerable people and providing services for a decent society', and cuts to company tax would compound the situation.[35]

2.37 The Australian Council of Trade Unions (ACTU) claimed that the cuts would result in approximately $51 billion in lost revenue, and noted that the Australia Institute had modelled a loss of $19.7 billion per annum after 2026–27.[36]

2.38 The Grattan Institute recommended the government defer the bill 'until we have eliminated the large and persistent budget deficits that increase the vulnerability of the Australian economy, and drag on future incomes'.[37]

2.39 Other submitters, however, suggested that critics had overstated the impact on revenue, particularly given the growth dividend that would result from the cuts. For example, the BCA argued that the proposed cuts would:

> …increase government revenues over time. Independent Economics (2016) estimates that more than half of the revenue impact will be clawed back through stronger growth which delivers higher revenues across all levels of government.[38]

2.40 The BCA further challenged the assumption that corporate tax levels as a share of the economy would fall as the corporate tax rate came down. In this regard, it noted that the corporate tax rate had fallen 19 per cent in the last 30 years, yet 'corporate tax collections are much higher as a proportion of GDP today'.[39] The BCA concluded that not proceeding with the Enterprise Tax Plan 'because of its revenue impact would be short-sighted and counterproductive'.[40]

2.41 The BCA also noted that Australia's dividend imputation system would temper some of the impact on revenue:

> Dividend imputation reduces the overall revenue impact of company tax cuts because part of the tax cut is clawed back from personal income taxes on dividends. Domestic shareholders will gain over time from stronger investment and a more buoyant economy.[41]

2.42 The CIS submitted that the expected growth in company tax receipts in future years would more than offset the cost of the cuts. It provided evidence showing:

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35 Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia, *Submission 21*, p. 1.

36 Australian Council of Trade Unions (ACTU*), Submission 15*, p. 3.

37 Grattan Institute, *Submission 5*, p. 1.

38 Business Council of Australia, *Submission 20*, p. 11.

39 Business Council of Australia, *Submission 20*, p. 16.

40 Business Council of Australia, *Submission 20*, p. 15.

41 Business Council of Australia, *Submission 20*, p. 17.

> …that the increased tax burden on companies in the next four years is more than the gross cost of the tax cut, and substantially more than the net cost. So the cost of the tax cut could be more than fully funded by the higher tax impost on companies over this four year period. Similarly, the total burden on companies will still be higher than today, even with the tax cut.[42]

2.43 The CIS also suggested that the economic benefits of the tax cuts would 'result in governments receiving more tax revenue, substantially offsetting the costs of the tax cut'.[43] The CIS noted that Treasury modelling showed that the economic growth dividend of the tax cuts would reduce their cost from 0.5 per cent of GDP to 0.3 per cent of GDP, and this remaining cost would be offset by three other measures in the 2016–17 Budget: anti-tax avoidance measures, increases to tobacco excise, and superannuation measures.[44]

2.44 The CIS also took issue with the argument that funds for a company tax cut should instead be used for other policies, such as education. The CIS argued that it was wrong to assume that company tax cuts would prevent other worthwhile investments. Moreover, the CIS submitted that the government only needed to choose between different policies where they had substantial budget costs. In the CIS's analysis, the benefits of the Enterprise Tax Plan appeared substantially greater than the costs, and the 'policy is budget neutral when combined with several other policies from the 2016–17 Budget, meaning there is no need to choose between the tax cut and other policy'.[45]

2.45 The MCA submitted that the cost to revenue from the tax cut is 'responsible and proportionate':[46]

> Claims that a company tax rate reduction will create a gaping hole in government revenue ignore offsetting revenue gains from increased tax collections stemming from the economic growth dividend and revenue costs pale in comparison to corporate tax revenues.[47]

2.46 The ACCI also pointed to a growth dividend as offsetting the impact of the cuts on government revenue:

> While tax revenue falls due to the lower headline rate, this is offset by revenue gains from increased profits and wages. A lower company tax rate

42 The Centre for Independent Studies, *Submission 13*, p. 4.

43 The Centre for Independent Studies, *Submission 13*, p. 14.

44 The Centre for Independent Studies, *Submission 13*, p. 24.

45 The Centre for Independent Studies, *Submission 13*, p. 26.

46 Minerals Council of Australia, *Submission 17*, p. 11.

47 Minerals Council of Australia, *Submission 17*, p. 1.

> also increases revenue by making it less cost-effective for companies to restructure their operations to avoid paying tax in Australia.[48]

Debate regarding the extent of the bill's benefits

2.47 Some submitters questioned whether the Enterprise Tax Plan would deliver the investment, economic growth, and jobs and wages growth envisaged by its proponents. For example, the ACTU challenged the idea that the tax cuts would do much to generate jobs growth, increase investment levels or lift living standards in Australia. It submitted that recent Treasury modelling found that cutting the company tax rate by one percentage point would 'serve mainly to benefit company profits in the short term, with an increase in GDP of only 0.1% and growth in jobs of less than 1% over two decades'.[49]

2.48 According to the ACTU, the majority of the benefit of the corporate tax cuts would flow through to higher company profits and shareholder dividends, rather than improved levels of business investment. With respect to the argument that the bill would led to higher levels of foreign investment, the ACTU contended:

> Much of the new foreign investment entering Australia originates in China and other regional nations with low company tax rates. Australia's 30 per cent company tax rate has not deterred these investments. In a world awash with investible funds and with record low interest rates, there is no compelling evidence that a further reduction in the cost of foreign capital through a reduction in the company tax rate would cause the surge in investment that proponents claim for it.[50]

2.49 The ACTU added that there was 'little or no evidence that investment decisions are significantly influenced by headline company tax rates'. This was particularly the case, it argued, because Australia is effectively competing against tax havens where the company tax rate was zero or close to it:

> Unless the company income tax base is repaired, demands made by Australian business organisations on behalf of foreign-owned corporations will be for ever-lower company tax rates until they are aligned with the negligible or zero rates enjoyed in tax havens.[51]

2.50 Several submissions also disputed the notion that the benefits of the tax cuts would flow through to higher incomes. For instance, the Grattan Institute submitted:

> The Government maintains that the change will boost GDP by more than 1 per cent in the long-term, at a budgetary cost of $48.2 billion over the

48 Australian Chamber of Commerce and Industry, *Submission 12*, p. 3.

49 Australian Council of Trade Unions (ACTU), *Submission 15*, p. 3.

50 Australian Council of Trade Unions (ACTU), *Submission 15*, p. 6.

51 Australian Council of Trade Unions (ACTU), *Submission 15*, p. 6.

> next 10 years. But the best analysis from the Commonwealth Treasury shows that the net benefits to Australians' incomes will be much smaller once profits flowing out of Australia are taken into account.[52]

2.51 Explaining its reasoning on this point, the Grattan Institute made a clear distinction between GDP and Gross National Income (GNI), explaining that given the benefits of the bill disproportionately flow to non-residents, this meant the relationship between GDP increases and GNI increases was weaker:

> A corporate tax cut increases economic activity (measured by GDP) by more than it increases national incomes (measured by GNI). When foreign-owned corporates pay less tax, more money flows out of the Australian economy. And most of the profits on their additional investments in Australia don't benefit Australians.
>
> Treasury estimated that cutting corporate tax rates to 25 per cent would only increase the incomes of Australians – GNI – by 0.8 per cent. Roughly a third of the benefits of greater economic growth would go to foreigners.[53]

2.52 The Grattan Institute further noted that Treasury's modelling indicated the benefit to GNI would be further reduced by the need to increase other taxes to make up for lost revenue. In sum, the 1.2 per cent increase to GDP would, based on Treasury's analysis, actually only result in a 0.6% increase in GNI after the share of extra GDP paid to foreign investors (0.4%) and the economic costs of increasing other taxes (0.2%) were taken into account. The reform, the Grattan Institute concluded, 'might still be worth doing, but it's less of a game changer'.[54]

2.53 Several submissions questioned the importance of tax settings to company's investment decisions, and in particular the effect of company tax settings on foreign investment levels. For example, JIMU, Uniting Church, suggested that multinational companies were attracted by a broad range of factors that informed macroeconomic stability, rather than just taxation policy. It added that several large OECD countries:

> …with relatively high tax rates are very successful in attracting FDI [Foreign Direct Investment], suggesting that market size, non-tax factors and taxable location-specific profits are particularly important in attracting FDI.[55]

2.54 For its part, the Grattan Institute submitted:

> Company tax cuts would be imperative if, without them, there would be no foreign investment in future. But tax cuts only affect decisions at the

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52 Grattan Institute, *Submission 5*, p. 1.

53 Grattan Institute, *Submission 5*, p. 4.

54 Grattan Institute, *Submission 5*, pp. 4–5.

55 Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia, *Submission 21*, p. 5.

margins. Despite a company tax rate of 30 per cent, more money was invested in mining projects in Australia than in any other country in the world for each of the eight years of the mining boom. Corporate investment decisions don't just turn on tax rates – they also consider Australia's stable government, educated workforce and developed economy.[56]

2.55 A large number of submitters, noting that some commentators had questioned the economic benefits of the bill, maintained that the overwhelming weight of evidence indicated the bill would deliver substantial economic dividends. For instance, KPMG suggested that while some 'outlier' modelling questioned the benefits of corporate tax cuts, mainstream models were in agreement that:

…corporate tax discourages investments and its incidence is largely borne by labour over the long term through lower real wages. Therefore, cutting company tax will have positive incentive effects for foreign investment and increase national income.[57]

2.56 The BCA challenged the notion that the costs of the Enterprise Tax Plan outweighed the benefits. Against a 10-year budget impact of $48 billion, the plan would deliver an annual $16 billion in *net* benefit, 'after taking into account the costs of raising offsetting taxes'. The BCA concluded:

The order of magnitude of the economic gain from cutting company taxes to 25 per cent is large, including by historical standards of estimated reform pay-offs.

To put this into context, the National Competition Policy reforms benefited the economy to the tune of at least $40 billion in today's dollars. These reforms took a decade to implement and required the combined effort of all levels of government, covering close to 1,800 pieces of legislation (National Competition Council, 2010; Productivity Commission, 2005). The 1988 general tariff reductions, a major economic reform, were estimated by the Commission (2000) to increase GDP by 0.5 per cent.

In this context, a company tax reduction of just five percentage points is a low cost, low effort and highly efficient way of delivering a significant permanent boost to GDP and national income.[58]

2.57 The CIS similarly claimed the impact of the tax cuts would be very substantive. Noting that Treasury had modelled an increase to GDP from the tax cuts of 1.0 to 1.2 per cent, the CIS observed:

Treasury has argued this gain to GDP is substantial, only slightly less than the combined benefit of the major reforms to telecommunications, ports and rail in the 1990s. The gain from the tax cut is also similar to the estimated

56 Grattan Institute, *Submission 5*, p. 6.

57 KPMG, *Submission 7*, p. 1.

58 Business Council of Australia, *Submission 20*, pp. 17–18.

> gain to GDP of 1.1% from an extensive range of reforms proposed by Infrastructure Australia, including large productivity improvements in gas, electricity, the NBN, telecommunications, water and transport. And these two examples are not single reforms, like a company tax cut, but a collection of numerous reforms covering many separate changes to regulations, and taking years to design and enact.[59]

2.58 The BCTR addressed the notion that company tax settings were not critical in informing investment decisions by foreign companies. While noting that there are multiple factors that shape Australia's overall investment profile, the BCTR explained:

> At the end of the day any prospective investor will still need to factor in our relatively high corporate rate when weighing up prospective investment decisions. Business tax rates do matter.[60]

2.59 Similarly, the Australian Financial Market Association (AFMA) maintained that while investment decisions were made with a view to a whole range of factors, corporate tax rates remained important:

> While the corporate tax rate alone is not the only tax disincentive for Australia as a destination for foreign capital, it is clearly an area where we have been slipping and tangible improvements can be made, such as through the measures proposed in the Bill.[61]

Treasury transfer effect

2.60 One of the arguments made against passing the bill was that for companies operating under a foreign tax credit system (primarily US companies) would in effect be required to pay any tax saving delivered by the Enterprise Tax Plan cuts to the government where the company was headquartered. According to this analysis, the bill would in effect result in a transfer of funds that would have been collected by the Australian Government instead being collected by the US Government.

2.61 This argument was put forward in submissions from the Australia Institute and the ACTU.[62] The ACTU summarised its concerns for the committee:

> By far the largest source of foreign investment in Australia is the United States. Where multinational corporations based in the United States do not engage in profit shifting to tax havens, the headline tax rate they face is the US rate of 35 per cent. Australia has double taxation agreements with the United States and numerous other countries. Under these agreements, US-based multinational corporations receive a credit for company tax paid in

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59 The Centre for Independent Studies, *Submission 13*, p. 19.

60 Business Coalition for Tax Reform, *Submission 9*, p. 3.

61 Australian Financial Markets Association, *Submission 18*, p. 1.

62 The Australia Institute, *Submission 29*, p. 3; Australian Council of Trade Unions (ACTU), *Submission 15*, p. 7.

> Australia. On profits earned in Australia they pay Australian company tax at the rate of 30 per cent, receive a credit for the 30 per cent paid in Australia and then pay the extra 5 per cent to the US Treasury. If the Australian company tax rate were lowered to 25 per cent, as advocated by the Business Council of Australia and other business groups, then tax-abiding US-based corporations operating in Australia would pay Australian company tax at the new, lower rate of 25 per cent but would be required to pay a total of 10 per cent to the US Treasury. There is no benefit to the corporation or to the incentive to invest in Australia but there is a large cost to Australian government revenue.[63]

2.62 A range of submissions suggested these concerns were based on a misreading of the impact of the treasury transfer effect. For example, the BCA rejected the argument that the cuts represented a 'free kick' to the US Government, and pointed out that the issue had already been accounted for in modelling:

> Some suggest this means a lower company tax rate here will simply lead to more tax paid in the US when profits are repatriated, with no net effect on rates of return and investment in Australia. However, most of the profits of foreign entities are not repatriated but retained in Australia. As a result, a reduction in the company tax rate in Australia will encourage US firms to invest here.
>
> The impact of foreign tax credits is already taken into account in the modelling of a company tax cut. The Henry Tax Review (2010) also considered this issue and concluded the impact in the Australian context is likely to be limited.[64]

2.63 Similarly, the CIS called the idea that the cuts would be 'gift' to the US Government a 'furphy', and emphasised that Australia should not forego a benefit to itself 'just because some non-Australians (including the US Treasury) also gain a benefit'. Like the BCA, the CIS also noted that the treasury transfer effect was likely to be limited, given US firms would have even more incentive to retain funds in Australia if the company tax rate was lower.[65]

2.64 Directly addressing claims by the Australia Institute that the value of the tax cuts to the US Treasury would amount to approximately $1 billion in 2026–27, the CIS submitted that:

> …this calculation has major flaws, rendering it of no value.
>
> First, the data they use has US companies paying total Australian tax of about $US2.9bn on average, but they are unable to indicate what proportion of this is from Australian company tax (as opposed to other Australian taxes). So the report guesses that the proportion is 80%. The report argues

63 Australian Council of Trade Unions (ACTU), *Submission 15*, p. 7.

64 Business Council of Australia, *Submission 20*, p. 17.

65 The Centre for Independent Studies, *Submission 13*, p. 29.

that the other possible Australian taxes would make up only a small portion of the total figure, stating that interest withholding taxes are low in value. However, the report doesn't (and probably couldn't) remove the effect of all other relevant Australian taxes. Hence there is no real analysis behind the 80% proportion, which the final figure of $1bn relies on. As this 80% figure is simply fabricated, the overall figure should be treated as being made up as well.

Second, the calculations do not include the impact of excess foreign tax credits. US companies with excess tax credits will feel no impact of an Australian company tax cut, as argued by Zodrow (2006). This will partly, or fully, offset the supposed 'transfer' to the US Treasury—but the Australia Institute does not even mention excess foreign tax credits, let alone estimate the impact on their figure.[66]

2.65 The BCTR reasoned that concerns about the foreign treasury transfer effect were 'completely misplaced':

In the first place, some 72 per cent of inbound investors in fact don't operate under a foreign tax credit system. Instead, their domestic tax systems treat foreign dividends as exempt, so that any reduction in Australian tax will clearly boost their after-tax return in Australia.

Secondly, those that do operate under a foreign tax credit system (almost exclusively US companies) do not face domestic top-up tax unless and until their foreign profits are repatriated to the US, which most Australian subsidiaries of US companies avoid doing. The Henry Tax Review also examined this issue and concluded the impact in the Australian context is likely to be limited.[67]

2.66 Similarly, the CTA advised that the concerns were misplaced:

Firstly, approximately 72% of inbound investment into Australia comes from countries outside the US and US investment into Australia is both in the form of portfolio and non-portfolio (being holdings greater than 10%) investment. It is only non-portfolio investment that could theoretically benefit. Secondly, US tax rules only tax foreign sourced profits from active business once those profits are repatriated and there seems significant evidence to suggest US companies do not repatriate foreign sourced profits. Thirdly, current proposals for US tax reform from both sides of US politics are proposing rules to encourage the repatriation of foreign sourced profit by reducing the US tax rate on these profits to below the proposed 25% Australian tax rate, so there will in fact be no incremental US tax if these reforms are implemented and profits repatriated.[68]

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66 The Centre for Independent Studies, *Submission 13*, p. 29.

67 Business Coalition for Tax Reform, *Submission 9*, p. 4.

68 Corporate Tax Association, *Submission 8*, p. 4.

2.67 KPMG also submitted that the 'assertion that a reduction of the Australian corporate tax rate will simply give rise to an increase in tax revenue for some foreign jurisdictions such as the US is a highly simplistic and incorrect analysis'.[69] It noted that only six OECD countries had a foreign tax credit system for the taxation of dividends from subsidiaries (the United States, Chile, Ireland, Israel, Korea and Mexico). Moreover, for countries with a foreign tax credit system, a 'substantial portion of profits that are made in Australia are not immediately repatriated'.[70]

2.68 The Grattan Institute, which in general argued against passing the bill, advised that the treasury transfer effect 'can be overstated':

> Foreign firms will only pay the extra tax when they repatriate profits earned in Australia to their home country. Many US firms have been very slow to repatriate profits for this precise reason.[71]

Effects of the dividend imputation system

2.69 Some submitters argued that the operation of Australia's dividend imputation system meant domestic investors would be largely unaffected by the corporate tax cuts, yet foreign investors would stand to receive a large benefit. The Grattan Institute explained:

> Australia's unusual dividend imputation system means that domestic investors are largely unaffected by the company tax rate since any profits paid to them are taxed at their personal income tax rate. Yet because foreign investors, by contrast, do not benefit from dividend imputation, a cut to the company tax rate provides bigger benefits to them. For those who have already made long-term investments in Australia, a reduction in the tax rate would be a windfall. Many of the international studies about the economic impacts of cutting corporate tax rates are therefore not readily applicable to Australia.[72]

2.70 The Grattan Institute also submitted that because of Australia's relatively unusual dividend imputation system,[73] Australia's effective corporate tax rate was in fact lower than its comparatively high headline rate would suggest, at least for local investors. It explained:

> By contrast, corporate taxes have a much bigger economic impact in other OECD countries where they reduce the rate of return for local investors.

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69 KPMG, *Submission 7*, p. 2.

70 KPMG, *Submission 7*, p. 11.

71 Grattan Institute, *Submission 5*, p. 3.

72 Grattan Institute, *Submission 5*, p. 1.

73 Most other countries tax corporate profits and then tax investors on dividends, although sometimes at a lower rate. Only five OECD countries operate a full imputation tax system—Australia, Canada, Chile, Mexico and New Zealand. Grattan Institute, *Submission 5*, p. 2.

> International comparisons show that Australia has a median level of taxes on corporate profits for local investors when both company taxes and individual income taxes are considered…
>
> Consequently, many of the international studies about the economic impacts of cutting corporate tax rates do not readily apply to Australia.[74]

2.71 The ACCI noted that some commentators have argued that only foreigners would benefit from a reduction in Australia's company tax rate because domestic investors receive personal tax credits through the dividend imputation system. The ACCI argued:

> This criticism ignores two important points. Firstly, domestic investors do use all the franking credits attributable to them. Secondly, the impact on foreign investors flows through to Australian households and businesses. When companies around the world are deciding where to set up and expand their operations, the tax rate they face is a major factor in determining their rate of return. If Australia is uncompetitive, they will invest elsewhere. As a result of decreased investment flows, Australians will bear the consequences of fewer jobs and lower living standards.[75]

2.72 The Ai Group acknowledged that Australia's imputation system for domestic shareholders:

> …will dilute the net benefits of the reduction in the company tax rate. This occurs because, other things being equal, the value of franking credits available to domestic shareholders per dollar of after-tax profit will fall and the lower quantity of tax paid at the corporate level will be associated with the distribution and use of correspondingly fewer imputation credits. Thus a dollar of pre-tax domestic profits company income distributed to domestic shareholders will bear the same level of tax both before and after the company tax reduction.[76]

2.73 At the same time, the Ai Group noted that 'the corollary to this is that there is no revenue cost in respect of domestic profits distributed to domestic shareholders'.[77] The Ai Group also argued that the company tax reduction still had decisive benefits, even with Australia's imputation system:

> First, in respect of capital provided by domestic shareholders, there is both an improved capacity to retain taxed profits in the company for reinvestment and also a higher incentive to retain and reinvest the profits. Thus, in respect of capital provided domestic shareholders, the impact of

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74 Grattan Institute, *Submission 5*, p. 2.

75 Australian Chamber of Commerce and Industry, *Submission 12*, pp. 7–8.

76 Ai Group, *Submission 24*, pp. 7–8.

77 Ai Group, *Submission 24*, pp. 7–8.

> the cut in the company tax rate is targeted very closely to the objective of reinvestment.
>
> Second, overseas shareholders cannot use Australia's imputation credits. The lower company tax rate therefore lifts incentives to invest both in respect of retained and distributed profits. As it is inherently more mobile than domestically-sourced capital on average, this additional impact on the incentive to invest from abroad is another dimension of the effective targeting of the company tax rate reduction.[78]

2.74 The CIS was also critical of the idea that the tax cuts should not proceed because they would have a greater impact in the short term on foreign shareholders than Australian shareholders. The CIS argued that it was:

> …truly perverse to argue that Australia should forego a benefit to our wages, employment, incomes, GDP, exports and investment, just because some foreigners benefit as well—this is a self-destructive form of xenophobia.
>
> In fact, if there are foreigners who benefit as well as Australians, this should strengthen the arguments for the tax cut. A policy that indirectly benefits foreigners should increase our support for the policy, not decrease it: just the same as a policy that caused collateral damage to foreigners should garner lower levels of support.[79]

2.75 Similarly, the BCTR argued that criticism of the fact foreigners would benefit from the cuts missed the point—that the cuts are intended to boost economic growth by encouraging greater business investment:

> Business would certainly want foreign investors (as well as domestic investors) to recognise that the after-tax return on both their existing and future projects is going to be enhanced as a result of the proposed measures. This will result in them boosting their investment levels above what they would have been without the rate cut, the benefits of which accrue mainly to wage earners.[80]

2.76 Several submitters challenged the suggestion that the imputation system meant that Australia's corporate tax rate was not as high as the headline rate would suggest (an argument, as noted above, made by the Grattan Institute). For example, the BCTR submitted:

> There is an argument that because Australian shareholders are able to offset company tax already paid against their own tax liabilities when they receive a dividend, the effective rate of company tax on the ultimate owners of the business is a lot less than 30 per cent. Reducing the corporate rate in fact

78 Ai Group, *Submission 24*, p. 8.

79 The Centre for Independent Studies, *Submission 13*, p. 29.

80 Business Coalition for Tax Reform, *Submission 9*, p. 3.

> means that Australian shareholders will be entitled to a reduced franking credit and will therefore pay more tax on the dividends they receive.
>
> This argument is questionable for a number of reasons. Firstly, the effect of dividend imputation is that the underlying income of the company is taxed at the shareholder's marginal tax rate. In some case (especially for super funds and many retirees) this will be lower than 30 per cent. However, in many other cases the marginal rate can be as high as 49 per cent.
>
> Secondly, while an analysis of the tax rate facing shareholders is interesting (if ambivalent – some are higher; others are lower), it is far from clear that many Australian domiciled companies make their capital investment decisions on the basis of the after-tax return for their shareholders. For listed companies, by far the most critical driver for them and their managers is reported earnings, and those earnings are worked out from the perspective of the company on an after-tax basis.
>
> Thirdly, the focus on Australian shareholders of listed Australian companies, while important, assumes we are a closed economy and totally ignores the position of foreign investors. Those investors and their shareholders do not benefit from imputation and their focus will always be on the after-tax outcomes for their Australian investments. For a capital-importing country such as Australia, the factors impacting on the investment decisions made by foreign investors have always mattered.[81]

2.77 KPMG noted that Australia's imputation system gives rise to a partial 'claw-back' of revenue lost as a result of a lower company tax rate. This, it argued, 'presents a more advantageous framework for lowering the company tax rate, rather than diminishing the need for doing so'.[82]

Concerns regarding corporate tax avoidance

2.78 Some submitters argued against the tax cuts on the basis that many corporations already pay too little tax. For example, the ACTU submitted that 57 per cent of ASX-200 companies 'used subsidiaries in tax havens to avoid paying tax in Australia and almost one third had an average effective tax rate of 10 per cent or less'.[83]

2.79 The CIS characterised the argument that the company tax cuts should not proceed because of supposedly widespread corporate tax avoidance as 'particularly odd':

> …it is effectively arguing that (a) taxes should remain unaffected at zero on the largest tax avoiders who pay no tax; but (b) taxes should remain highest on those businesses who pay the full rate of tax. Similarly, cancelling the

81 Business Coalition for Tax Reform, *Submission 9*, pp. 2–3.

82 KPMG, *Submission 7*, p. 2.

83 Australian Council of Trade Unions (ACTU), *Submission 15*, p. 9.

> tax cut will have the greatest harmful effect on the businesses who pay the most tax and the smallest impact on those who pay the least tax.[84]

Other issues raised in submissions

2.80 Some submissions, while in varying degrees supportive of the bill, suggested ways in which the bill could be improved. Issues raised included: the operation of the imputation system as the corporate tax rate was reduced; issues concerning the definition of a 'small business' for tax purposes; the $1,000 cap on the small business income tax offset; and whether the staged approach to the tax cuts is appropriate. The next part of this report summarises these issues, as raised in various submissions.

Operation the imputation system

2.81 As noted in the previous chapter, the bill provides that as the corporate tax rate reduces, so too does the maximum imputation credit that can be attached to dividends. Some submitters, such as Pitcher Partners, expressed concern that this might create an 'inequitable imputation outcome for shareholders' where retained profits were not paid out in the year they were earned.[85] Pitcher Partners explained its concerns in this regard:

> Broadly, this means that retained profits that have been taxed at the current corporate tax rate of 30% may be subject to a reduced imputation rate (i.e. 27.5% until the year ended 30 June 2024) rather than the corporate tax rate actually paid. This will result in shareholders paying a higher amount of "top-up" tax on dividends paid by the company. As private companies generally retain profits for working capital, this results in a disproportionate cost to small and middle market taxpayers when they finally release their profits that were taxed at the higher rate.[86]

2.82 Pitcher Partners further explained the cost to small and medium sized companies of the approach currently contained in the bill. Pitcher Partners suggested that SMEs tended to be more reliant on retained profits than larger companies (which typically have better access to other avenues of funding).[87] It also observed that because many SMEs will transition to the reduced corporate tax rate on 1 July 2016 (that is, retrospectively), these companies will not have the ability to minimise the impact of the new measures on their franking account balances.[88]

2.83 Pitcher Partners put forward two options for 'transitional relief': allowing after-tax profits that existed as at 30 June 2016 to be franked at the 30 per cent rate; or

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84 The Centre for Independent Studies, *Submission 13*, p. 27.

85 Pitcher Partners, *Submission 4*, p. 1.

86 Pitcher Partners, *Submission 4*, p. 2.

87 CPA Australia, *Submission 3*, p. 3.

88 Pitcher Partners, *Submission 4*, p. 2.

a transitional approach that allowed pre-existing profits to be franked for at 30 per cent for a limited amount of time after the transition date (for example, up to five years). Pitcher Partners acknowledged that both options would have a cost to revenue.[89]

2.84 The CTA also expressed concern about a situation where a company with a company tax rate of 27.5 per cent (and eventually 25 per cent) pays a dividend sourced from years where the profits are taxed at 30 per cent:

> …this effectively results in franking credits being 'trapped' in the company unless the company starts to derive more income that is exempt in its hands (such as dividends from certain foreign operations).
>
> The implication of this is that there will be a significant incentive for companies to pay out all retained profits prior to the change in the corporate rate to avoid wasting the credits as to do otherwise will result in an effective permanent cost to shareholders, as the tax can never be claimed as a credit.[90]

2.85 The CTA submitted that a better approach would be to allow companies to:

> …frank their dividends to the 30% rate until such time as its 30% franking credit balance is fully utilised. This could possibly be managed by quarantining a 30% franking account and the establishment of other franking accounts that could trace tax paid to the respective income year, and allow corporates the ability to frank dividends at the requisite tax rate from that account or allowing companies to continue to frank at the 30% rate until the 30% franking balance is exhausted.[91]

2.86 The Tax Institute suggested it was unclear whether in fact the government intended that a company would be allowed to frank dividends based on the corporate tax rate they had paid, or if it would be based on the rate paid in the current income year.[92] However, like Pitcher Partners, the Tax Institute suggested:

> The draft law appears to operate such that if the corporate tax rate paid in the previous income year is higher than the rate that applies in the current year, the entity will only be able to frank dividends to the extent of the lower corporate tax rate. This would have the effect of 'trapping' franking credits in the entity.[93]

2.87 The Tax Institute expressed concern in this regard, and submitted that the 'correct policy outcome should be to permit an entity to frank dividends at the rate of

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89 Pitcher Partners, *Submission 4*, p. 4.

90 Corporate Tax Association, *Submission 8*, p. 5.

91 Corporate Tax Association, *Submission 8*, p. 5.

92 The Tax Institute, *Submission 14*, p. 2.

93 The Tax Institute, *Submission 14*, p. 2.

tax a corporate tax entity has paid consistent with the broader imputation credit system'.[94]

2.88 While supportive of the bill in principle, the FPA highlighted the same issue regarding franking credit calculations:

> We would also highlight that while the proposed solution for franking credit calculations is pragmatic, the assumption that profits are distributed by businesses in the year they are earned (Explanatory Memorandum 1.71) is not always the case, particularly in small companies where it is a common practice to withhold profits to later financial years. This will lead to (for example) the business paying tax at as much as 30%, but only able to distribute a 25% franking credit when the profits are distributed.[95]

2.89 Several other submitters expressed concern about this aspect of the bill, including Chartered Accountants Australia and New Zealand, which suggested that a transitional arrangement that would allow dividends to be franked at the rate they had been taxed.[96]

Definition of a 'small business'

2.90 Several submissions expressed some reservations about growing complexity around the definition of a 'small business' for tax purposes. Business SA, while supportive of the reductions in the company tax rate, expressed concern that the bill 'introduces additional complexity to small business tax arrangements by not aligning thresholds for small business tax concessions'. It noted, in particular, that:

> On the basis that the company tax rate reduction only applies to businesses with revenues less than $10 million, the same businesses should have equal access to existing small business tax concessions, particularly small business capital gains tax concessions.[97]

2.91 Chartered Accountants ANZ also expressed concern that the bill would create some new complexity, with small businesses 'now confronted with at least three turnover tests':

> $10 million for simpler depreciation rates and trading stock rules, immediate deductibility for small business start-up expenses, roll-over for restructures of small business, immediate deductions for certain prepaid business expenses, accounting for GST on a cash basis, paying GST by quarterly instalments, fringe benefits tax car parking exemption, annual apportionment of input tax credits for acquisitions and importations that are

94 The Tax Institute, *Submission 14*, p. 2.

95 Financial Planning Association, *Submission 10*, p. 1.

96 Chartered Accountants Australia and New Zealand, *Submission 23*, pp. 2–3.

97 Business SA, *Submission 19*, p. 1.

partly creditable and pay-as-you-go instalments based on gross domestic product adjusted notional tax.

$5 million for the small business income tax offset.

$2 million for the small business capital gains tax concessions.[98]

2.92 Chartered Accountants ANZ submitted that ideally 'there should be one consistent definition of small business under the tax law and one turnover', and harmonisation of the definition in both Commonwealth and state legislation.[99]

$1000 cap on the small business income tax offset

2.93 Some submitters while supportive of the increases in the rate of the small business tax offset for unincorporated small businesses, argued that the $1000 cap should be lifted over time to ensure the tax discount remained broadly equivalent to the small business company tax rate cuts. As Chartered Accountants ANZ explained:

> As currently drafted, the small business offset will provide a small business owner a 5% discount. However, when the company tax rates are reduced below 28.5% and the discount rises, it is unclear how the offset provides a discount broadly equivalent to the small business corporate tax rate, given that the offset is capped at $1,000. The capping of the offset at $1,000 means that as the discount component increases, the maximum amount subject to the offset decreases.[100]

Comments regarding the 'phase in' approach

2.94 Several submitters, including the CIS and the CPA, indicated that while they supported the bill, they would prefer more expeditious shift to the 25 per cent corporate tax rate.[101] While indicating that its preference would have been for a shorter implementation timeframe, Chartered Accountants ANZ acknowledged that:

> …that the immediate revenue impact of extending the corporate tax rate reduction to all corporates would be significant and could not have been achieved without also implementing other major tax reforms.
>
> Accordingly, the road map contained in the Bill is helpful.[102]

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98 Chartered Accountants Australia and New Zealand, *Submission 23*, p. 9.

99 Chartered Accountants Australia and New Zealand, *Submission 23*, p. 9.

100 Chartered Accountants Australia and New Zealand, *Submission 23*, p. 3. Similar concerns were expressed by the IPA and the CTA. Institute of Public Accountants, *Submission 11*, p. 7; Corporate Tax Association, *Submission 8*, p. 6.

101 The Centre for Independent Studies, *Submission 13*, p. 30; CPA Australia, *Submission 3*, p. 1.

102 Chartered Accountants Australia and New Zealand, *Submission 23*, p. 2.

2.95 Other submitters, such as the Council for Small Business Australia, argued in support of the staged approach, and underlined the need to build community support for tax cuts for large businesses:

> We also support the staggered roll out of the changes. The Australian community, including the small business community, has become suspicious of a number of big businesses who seem to be dodging their tax and abusing the tax system. The facts as we see them are that 90% of businesses, of all sizes, pay their due tax and are fine ethical and responsible members of the Australian community. The few that don't give the rest a bad name. Those few also make a negative impact on the federal budget and the economy and need to be bought to task. We understand that the ATO is undertaking that task. When the general community sees that the recalcitrant businesses, and indeed the dishonest businesses, are being dealt with then the staggered approach can be accelerated and the tax cuts could be introduced earlier for big businesses.[103]

2.96 Similarly, KPMG argued that the phased approach 'has economic advantages as well as giving rise to greater community acceptance'.[104]

Committee view

2.97 The committee considers the Enterprise Tax Plan, as set out in the bill, a critical reform that will improve Australia's tax system for businesses and drive investment and growth in the economy. There is clear and compelling evidence that the benefits of the Enterprise Tax Plan will ultimately flow through to growth in jobs and wages, helping to improve Australian living standards overall.

2.98 The committee is also satisfied that the substantial economic benefits of the Enterprise Tax Plan more than outweigh its cost to revenue, which will at any rate be largely offset by higher levels of economic growth.

2.99 The overwhelming evidence received by the committee suggests concerns that the tax cuts would largely result in a 'transfer' of revenue from the Australian Government to the US Government are not well founded. The committee also notes that this issue has already been considered in modelling of the Enterprise Tax Plan.

2.100 The committee acknowledges that some submitters raised concerns about the operation of the imputation system during the transition to a lower corporate tax rate. However, the committee is satisfied that the approach set out in the bill, and explained in the Explanatory Memorandum,[105] is appropriate. The committee understands that the approach in bill is also broadly consistent with the approach taken when the

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103 Council of Small Business Australia, *Submission 25*, pp. 2–3.

104 KPMG, *Submission 7*, p. 1. For more detail, see p. 8 of KPMG's submission.

105 Explanatory Memorandum, pp. 24–27.

corporate tax rate was reduced from 36 per cent to 34 per cent in 2000 and from 34 per cent to 30 per cent in 2001.[106]

Recommendation 1

2.101 The committee recommends that the bill be passed.

Senator Jane Hume
Chair

106 Explanatory Memorandum, *New Business Taxation System (Miscellaneous) Bill 1999*, p. 28; Explanatory Memorandum, Tax Laws Amendment Bill (No. 2), pp. 16–17.

Labor Senators' Dissenting report

Background and Overview

1.1 Labor is committed to a budget and a taxation system that links effort and reward in a fair way. Labor is also committed to taking responsible decisions that improve the sustainability of our public finances, reduce the risk of a credit rating downgrade and ensure we can make targeted investments that promote inclusive growth.

1.2 Labor always approaches budget repair in line with our values and priorities. The Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016 (the bill) as drafted contains measures that are contrary to Labor's values and priorities. Labor supports a reduction in company taxation that supports small businesses, but given existing fiscal pressures, now is not the time to be delivering tax relief for large businesses.

1.3 The Government contradicts itself when it talks about budget repair while proposing to deliver a $50 billion dollar tax cut at a time when Australia is at risk of losing its AAA credit rating.

Specific measures

2.1 Labor Senators are committed to working constructively with the Government to find ways to support small businesses while protecting the integrity of the budget.

2.2 Labor Senators propose the following amendments to the bill:

- Only reduce the company tax rate to 27.5 per cent for businesses with a turnover of less than $2 million (the threshold that remains consistent with the ATO definition of a small business);

- Only increase the unincorporated small business tax discount from 5 per cent to 8 per cent, and only for businesses with a turnover with a turnover of less than $2 million; and

- Not proceed with the increase to the small business entity threshold.

2.3 The Grattan Institute made a submission and stated that the best analysis from the Commonwealth Treasury shows that the net benefits to Australians' incomes will be much smaller once profits flowing out of Australia are taken into account. In addition, a cut to the corporate tax rate places pressure to raise taxes in other areas and the benefits from additional investment may take time to emerge.

2.4 The Australian Council of Social Service (ACOSS) also stated in its submission that it is a flaw in current fiscal policy to reduce company tax while keeping an over-reliance on bracket creep in income tax to restore tax revenue. ACOSS also stated that more substantial economic benefits can be realised by

increasing public investment at a time when money is historically cheap to borrow and to increase investment in workforce participation and education.

2.5 Labor Senators believe that investments to infrastructure, education and healthcare will deliver greater returns than the benefits of the corporate tax cut set out in this bill.

2.6 Labor Senators believe that changes to this bill will deliver needed support to small business while protecting Australia's AAA credit rating. Labor Senators also call on the Government to abandon fiscal recklessness and instead work cooperatively to continue the work of budget repair in a way that is fair.

Senator Chris Ketter
Deputy Chair

Senator Jenny McAllister
Senator for New South Wales

Appendix 1

Submissions received

Submission Number	*Submitter*
1	Financial Services Council
2	Chamber of Commerce and Industry Queensland
3	CPA Australia
4	Pitcher Partners
5	Grattan Institute
6	Australian Council of Social Service (ACOSS)
7	KPMG
8	Corporate Tax Association
9	Business Coalition for Tax Reform
10	Financial Planning Association
11	Institute of Public Accountants
12	Australian Chamber of Commerce and Industry
13	The Centre for Independent Studies
14	The Tax Institute
15	Australian Council of Trade Unions (ACTU)
16	PricewaterhouseCoopers
17	Minerals Council of Australia
18	Australian Financial Markets Association
19	Business SA
20	Business Council of Australia
21	Synod of Victoria and Tasmania, Uniting Church in Australia
22	Australian Institute of Company Directors
23	Chartered Accountants Australia and New Zealand
24	AI Group
25	Council of Small Business Australia
26	Australian Dental Industry Association (ADIA)
27	National Electrical and Communications Association (NECA)
28	Australian Small Business and Family Enterprise Ombudsman
29	The Australia Institute