



SUBMISSION

Inquiry into the 'Commitment to the Senate' issued by the Business Council of Australia

April 2018

www.bca.com.au

CONTENTS

The Business Council and its members reaffirm their commitment to the Senate	3
Company tax cuts will encourage the investment needed for stronger growth	4
The Enterprise Tax Plan is needed to keep Australia in the game	4
Lower company taxes will increase business investment	5
If accelerated depreciation increases investment, so too will a company tax rate cut	7
Higher investment will flow through to more jobs and higher wages overall	9
Impacts of all policies should be assessed as a matter of course	10
The economy-wide benefits of a lower company tax rate are supported by evidence	11
Business Council members pay more than 36% of company tax paid in Australia	13
Reducing the company tax rate for all businesses is the top priority for tax reform	14
The proposed reduction in the company tax rate withstands scrutiny	15
Attachment 1: Responding to criticisms	17
Companies pay a large amount of tax	17
Company tax cuts will flow through to workers	17
The estimated benefits of a tax cut incorporate dividend imputation	17
The tax cut is fiscally responsible	18
Australia's effective tax rate is high by global standards	19
We cannot assume foreign investors will ignore Australia's increasingly uncompetitive tax rate	19

The Business Council of Australia draws on the expertise of Australia's leading companies to develop and promote solutions to the nation's most pressing economic and social challenges.

The Business Council and its members reaffirm their commitment to the Senate

The Business Council and its members welcome the opportunity to respond to the Senate Inquiry into the “*Commitment to the Senate*” issued by the Business Council of Australia on 21 March 2018 and to reaffirm their commitment.

Business Council members employ over one million people and paid over \$23 billion in company tax in 2015-16.

“We believe that a reduction in the corporate tax rate, as proposed through the Government’s Enterprise Tax Plan, is urgent and vital to keep Australia competitive.

If the Senate passes this important legislation we, as some of the nation’s largest employers, commit to invest more in Australia which will lead to employing more Australians and therefore stronger wage growth as the tax cut takes effect.”

The commitment is predicated on the Enterprise Tax Plan being implemented over the next nine years as scheduled.

- ▶ The Plan is measured, fiscally responsible and fully accounted for in budget projections, including a forecast return to surplus by 2020-21.
- ▶ Businesses will be able to bring forward investments ahead of actual tax cuts if they are confident that the lower rates will apply as investments come on stream.
- ▶ If the tax cuts are locked in legislation (and not reversed), over half the gains could accrue by the time the Enterprise Tax Plan is fully implemented.¹

Company tax cuts under the Enterprise Tax Plan

The *Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017* will gradually extend the 27.5% tax rate now applying to smaller companies to companies of all sizes by 2023-24. The rate will then be lowered to 27% in 2024-25, then 26% the following year and 25% in 2026-27.

¹ KPMG, *Modelling the Macroeconomic Impact of Lowering the Company Tax Rate in Australia*, 2016.

Company tax cuts will encourage the investment needed for stronger growth

- ▶ To deliver the steady improvements in living standards Australians have come to expect, annual economic growth needs to be at least 3%, not its current level of 2.4%.
- ▶ Stronger investment by businesses that already generate 80% of economic activity and employ over 10 million people² in Australia will be central to getting the economy and wages growing strongly again — as it has been for decades.
- ▶ Businesses invest to expand their operations, improve their efficiency, develop new products and markets, and build the skills of their employees. This is how investment creates jobs and drives higher incomes.
- ▶ The evidence is overwhelming that company tax cuts will encourage stronger investment, which in turn will drive stronger jobs and income growth. It is irrefutable that tax rates affect investment decisions.
- ▶ Australia is in an intense global contest for capital. We are a net capital importing country. Investors have choices about where they put their capital around the globe and we are being naïve if we think Australia's business taxes do not have to be competitive. The IMF has said that the recent US company tax cut will draw substantial investment funds into the US from global markets.³
- ▶ Australia's business taxes cannot continue to be set in isolation from these global realities.

The Enterprise Tax Plan is needed to keep Australia in the game

- ▶ Our headline company tax has remained at 30% for close to 17 years while other countries have reduced their rates. We now have the 3rd highest rate in the industrialised world.
- ▶ Even with the rate cuts proposed in the Enterprise Tax Plan, Australia would remain above the current OECD average of 24% and Asian country average of 21%.
- ▶ As the rest of the world moves, doing nothing does not mean nothing happens. For example, KPMG Economics suggests recent US tax reforms could permanently reduce Australia's GDP by at least 0.3% (or \$5.1 billion) and lead to around 25,500 fewer jobs.⁴

² ABS cat. no. 5206.0 and 6291.0.55.003.

³ IMF, *World Economic Outlook*, October 2017.

⁴ KPMG, *A global game changer: An analysis of the Trump tax reforms*, 2018.

Lower company taxes will increase business investment

Despite a recent welcome uplift, new business investment as a share of GDP remains low, at a level last seen in the early days of recovery from the 1990s' recession (Figure 1).

Figure 1: New business investment is still the lowest it's been as a share of GDP for more than 20 years



Source: ABS cat. no. 5206.0

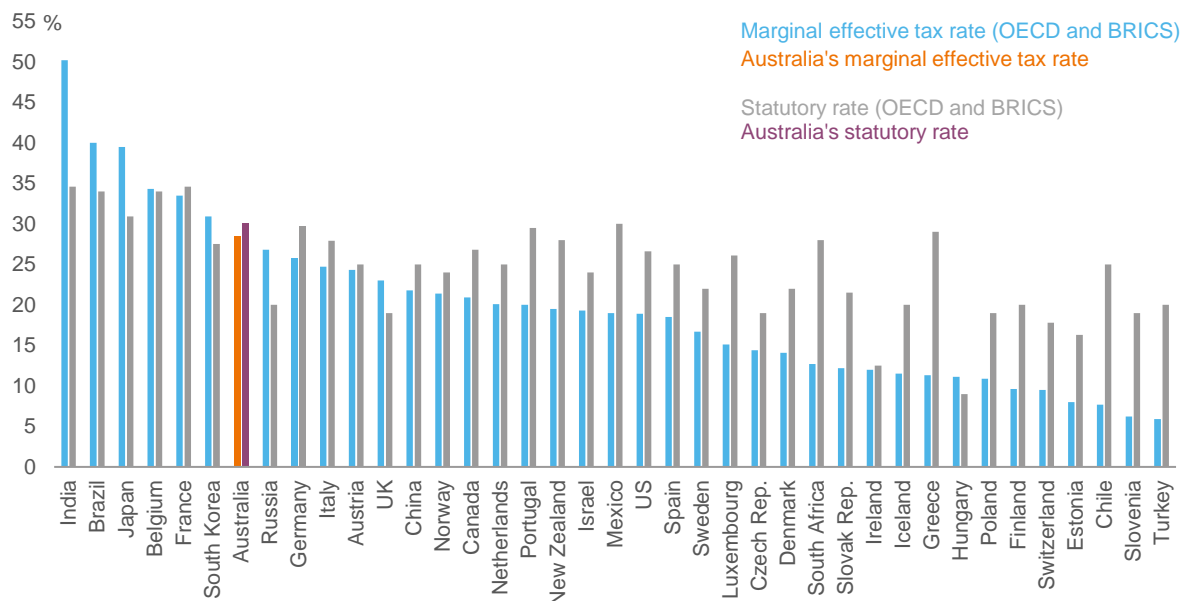
There are many reasons for this slow down and its persistence and no one is suggesting that tax is the only factor affecting investment decisions. Politicisation of investment projects, delayed project approvals and moratoriums on gas exploration are just some of the impediments to stronger investment.

But it is clear that Australia's 30% company tax rate (and 28.4% effective marginal rate) imposes a large distortion on investment and the economy (see Figure 2).⁵ It sets a higher rate of return hurdle for new investments in Australia than in many other countries. The gap has widened in recent years and is set to widen further with rate cuts scheduled in the UK, France, Belgium and the Netherlands. In a world of highly mobile capital, a net capital importer such as Australia cannot afford to lag.

A globally competitive company tax rate is one of the most direct and effective economy-wide policy levers we have at hand for boosting investment and there is a proposal on the table to do something about it.

⁵ Bazel and Mintz, *Australia's investment challenge in wake of 2018 US tax reform*, commissioned by the Minerals Council of Australia, 2018.

Figure 2: Australia's headline and marginal rates are near the top of the global pack



Note: Belgium and France have legislated to drop their statutory rates below 30%.

Source: Bazel and Mintz, *Australia's investment challenge in wake of 2018 US tax reform*, 2018.

Lower company taxes work by increasing the expected after-tax return on investment. A higher expected after-tax return means that some projects that would otherwise not go ahead become viable.

Numerous Business Council members have said publicly that they will increase investment spending if the company tax rate is reduced to 25% over a decade. Locking in future tax cuts will provide a credible signal to potential investors to bring forward investments. Even stronger commitments could be made if the tax cuts took effect immediately (and were not under threat of reversal).

These additional investments will span a wide array of industries, locations and activities including:

- developing new markets
- building and expanding plant and structures
- buying machinery and equipment
- introducing new technologies to produce more goods and services more efficiently
- investing in innovation
- investing in skills of employees
- resource exploration and development.

What a 25% company tax rate could do for an agribusiness exporter

Agribusiness Ltd is looking to invest \$200 million in a new processing facility and the board has set a 10% rate of return for the investment to go ahead reflecting the riskiness of the project. Under a 30% company tax rate the project has a 9% rate of return and cannot fully recoup its cost of capital. Therefore, it is not viable. If the company tax rate is reduced to 25%, the project would have an 11% rate of return and a net benefit of \$10 million in today's terms. The project is now viable and will proceed.

What a 25% company tax rate could do for a mining company

Mining Ltd is looking to invest \$1 billion in a new mine. The mine is a riskier proposal than for Agribusiness Ltd's processing plant, so the board has set a hurdle rate of 15%. Under a 30% company tax rate the rate of return is 14% so the project cannot fully recoup its cost of capital. However, under a 25% company tax rate the project is expected to make \$70 million in today's terms. The rate of return is now 16%. Because the project is now profitable, it will proceed.

What a 25% company tax rate could do for an advanced manufacturer

Advanced Ltd is looking to invest \$500 million in a new advanced manufacturing plant. It has a choice between Australia and New Zealand. Both countries provide a highly skilled workforce, good infrastructure and relatively stable and predictable systems of laws, however New Zealand's 28% company tax rate compares with a reduced rate of 25% in Australia. The project is expected to make \$80 million (a 13% rate of return) if it goes ahead in New Zealand, or \$110 million if it goes ahead in Australia (a 14% rate of return). Thus, if the company tax rate were to fall to 25%, the company will build the plant in Australia rather than New Zealand.

If accelerated depreciation increases investment, so too will a company tax rate cut

The Business Council has welcomed the Opposition's investment guarantee scheme. By proposing to introduce accelerated depreciation for certain investments, the Opposition is acknowledging that lower company taxes encourage stronger investment.

This is because both accelerated depreciation and company tax cuts work by reducing tax payable on profits earned from investing.

Those claiming that accelerated depreciation is superior to cutting company taxes misunderstand how company taxes work. Company tax cuts reduce tax payable for any given taxable income; accelerated depreciation reduces tax payable by reducing taxable income in the early years of an investment. Either way, the effect is to increase the after-tax return on investment.

True, accelerated depreciation will only apply to new investments, thus reducing so-called 'windfall' gains to owners of existing investments. But it is also the case that investment allowances apply upfront when investment expenditure is made, not when profits eventually flow from it. This means investment allowances bring forward the budget cost for new investment relative to company tax cuts. Phasing in of a tax cut as proposed under the Enterprise Tax Plan will reduce windfall gains on existing investments and upfront fiscal costs.

While both measures benefit businesses regardless of size, accelerated depreciation may also help small businesses with limited financing options in the short term.

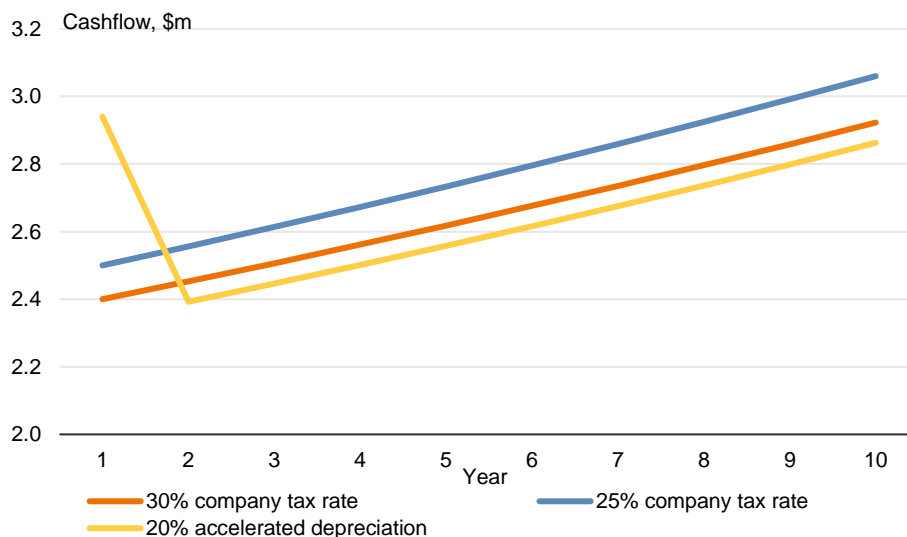
But the main difference in practice is that the proposed company tax cut will have a bigger benefit across the board — the Guarantee would deliver a significantly smaller increase in after-tax cash returns to the company over time than the proposed company tax reduction to 25% (Figure 3). That is the major reason why its projected budget impact is less. (If it gave the same investment boost, the fiscal impacts would be broadly similar over time.)

As the impact on after-tax investor returns is less, it follows that the boost to investment and jobs will be correspondingly smaller. Exactly how much smaller is unknown as, unlike the Enterprise Tax Plan, modelling of the effects of the proposal on investment, jobs and wages has not been released.

The proposed guarantee also applies to a narrower range of investments than the tax cut which is ‘investment neutral’. For example, the guarantee excludes buildings and structures and, although it covers some forms of intangible investment, it will be unable to capture all of them such as investments in staff training. This is simply because some of these investments are immediately expensed and therefore cannot benefit from an accelerated depreciation schedule.

Thus, the Investment Guarantee risks discouraging categories of investment that will be vital for a successful, knowledge-based, 21st century economy. Not favouring one form of investment over another is an important advantage of an across-the-board tax cut.

Figure 3: A stylised example of net cashflow for an investment project with a tax cut to 25% vs 20% accelerated depreciation



Source: Business Council of Australia. Note: The baseline example is for a \$10 million investment depreciated over 10 years on a straight-line basis. Revenue and expenditure are \$5 million and \$2 million respectively, in the first year. The inflation rate is assumed to be 2.5% a year.

Higher investment will flow through to more jobs and higher wages overall

When individual businesses invest more, their capacity to hire people and pay them more increases. For example:

- An expansion in investment means that there are more facilities and new equipment to be operated and goods and services to be produced.
- Investment in developing new markets requires more workers and requires more products and services to be produced.
- When a business invests in the skills of its employees, pay rates rise commensurately.

The overall effect of increased investment and increased demand for labour by individual businesses is for labour demand to rise across the economy. This translates to an increase in both the aggregate number of jobs and hours worked as well as the wages received by workers. Aggregate and average labour income increase.

This link from investment to jobs and incomes is not ‘trickle-down’ economics (noting that this term has no agreed definition). It is not ideology. It is how an economy grows and delivers higher living standards across the community. There is a straight line from increased business investment to higher labour productivity to higher incomes for workers.

Growth in investment has been the single biggest driver of recent per capita income growth in Australia. It has accounted for around half of income growth per person over the past two decades. (Multi-factor productivity (MFP), the terms of trade and increased labour utilisation combined accounted for the remaining half.)⁶

- PwC estimates that for a 5% fall in foreign and domestic investment in Australia (excluding investment in mining and property) in 2018, GDP could decline by \$3.3 billion and 29,000 jobs would disappear.⁷
- In contrast, stronger investment underpinning higher labour productivity would see higher incomes and jobs growth. If real GDP growth returned to the average 3.3% per year achieved over the past 50 years, the economy would be over \$1 trillion bigger (in today's dollars) after 40 years than on growth projections from the latest Intergenerational Report.

Over coming decades, investment will likely have to do even more of the heavy lifting (along with MFP growth) as the population ages. And we cannot rely on higher export prices, which are outside our control.

The Business Council is encouraged that the Opposition has acknowledged this crucial link between investment, growth and jobs by proposing the Australian Investment Guarantee.

The Shadow Treasurer is right that recent business investment has been disappointing. Locking in stronger investment will be vital for underpinning jobs and wages growth.

This is the challenge that the Government's Enterprise Tax Plan is also seeking to address. And because it provides greater incentives than the Opposition's proposal, the Plan will stimulate more investment with commensurately larger economic benefits.

⁶ ABS cat. no. 5260.0.55.002 and 5206.0.

⁷ PwC, *Imagine the “unimaginable”*, 2018.

Impacts of all policies should be assessed as a matter of course

In relation to part (a) of the terms of reference, the Business Council strongly endorses the Committee's desire to measure the impacts of the Enterprise Tax Plan on investment, wages and jobs.

The Business Council has consistently called for governments to ensure that their actions deliver net community benefits. Unfortunately, Australia does not have an embedded culture of independent and transparent policy assessment and evaluation.

Therefore, it is encouraging to see the Senate Committee champion policy evaluation. We would urge the Senate to make this the norm for all policies, including the proposed investment guarantee.

Policy evaluations require appropriate methodologies. The proposed monitoring of annual investment, employment and wages for a small subset of companies would not capture the economy-wide impacts of the Enterprise Tax Plan. Individual business responses to the company tax cut will differ. Not every business has to increase its investment by the same amount and at the same time for a company tax cut to benefit the economy.

Indeed, it would be surprising if all companies said they would respond to the tax cut to the same degree and in the same way at the same time. Individual businesses face different challenges, operate in different markets and have different investment cycles. Some will expand as others contract. Importantly, capital will flow to those companies with good investment proposals.

The key metrics for assessing the impact of a tax cut are whether *aggregate* new business investment, wages and employment are higher than otherwise over time. The Australian Bureau of Statistics already measures and reports on new business investment, wages and employment and these data would provide a more robust statistical basis for assessment.

The Business Council would strongly support an independent review of the Enterprise Tax Plan after it has been fully implemented. This review should also include analysis of the global competitiveness of Australia's company tax rate at the time.

The economy-wide benefits of a lower company tax rate are supported by evidence

As noted above, lower company taxes work through raising aggregate new business investment. Higher investment increases business demand for labour, flowing through to higher wages and employment.

There are essentially two ways of measuring the impacts of the tax change — ‘ex ante’ stylised modelling of a policy ‘shock’ to the economy (holding all else constant) and ‘ex post’ econometric evaluation of the impact of the change over time (which attempts to isolate the impact of the change from other factors).

Both methodologies have been used to estimate the impacts of company tax cuts and both consistently demonstrate large benefits:

- ▶ By encouraging additional investment and labour productivity (output per labour hour). Treasury modelling estimates that a 25% company tax rate would increase annual GDP by a net 1% (\$18 billion in today’s terms) in perpetuity.⁸
 - Over half the benefits from a tax cut flow to Australian workers. Real wages would be more than 1% higher — in today’s economy, around \$750 extra per year for an average wage earner.
 - Government revenues would be around \$4 billion higher (in today’s terms) every year.
- ▶ OECD analysis has found that higher marginal effective company tax rates are associated with lower *rates* of economic growth and therefore a smaller economy in the long term.
 - The OECD finds that this negative relationship is “strongly significant [and] statistically stable”. The presence of dividend imputation offsets this effect to some extent but does not negate it (particularly for a net capital importing country like Australia). The analysis also finds that a revenue-neutral company tax cut does not increase inequality.⁹
- ▶ The OECD has found that lower corporate tax rates promote total factor productivity growth of the most dynamic and innovative enterprises, encouraging greater dynamism and the spread of technology and knowledge spillovers throughout the economy.¹⁰

What the experts say

Dr Martin Parkinson, current Secretary Department of the Prime Minister and Cabinet

‘Sometimes the winners are not obvious. While always uncertain, recent work...suggests that more than half of the long run economic burden of corporate tax is borne by wages. Paradoxically, then, wage earners may be big winners from a company tax cut.’

Dr Ken Henry, former Secretary of the Treasury

‘...the consensus of public finance theorists is that in Australia, if the company income tax were to be cut, the principal beneficiaries will be workers’.

⁸ Treasury, *Economy-wide modelling for the 2016-17 Budget*, 2016.

⁹ OECD, *The effects of the tax mix on inequality and growth*, 2017.

¹⁰ OECD, *Tax Policy Reform and Economic Growth*, 2010.

Chris Richardson, Partner, Deloitte Access Economics

‘This is not a zero sum game in which if companies win, workers lose. We can tax smarter and we can [...] a more prosperous Australia — a bigger pie — if we do this right.’

‘The national debate on this has been wilfully ignoring what the experts and the modellers say, and there is a risk that we are just about to leave \$20 billion a year of reform dividends lying in the gutter.’

OECD

‘Corporate income taxes are the most harmful for growth as they discourage the activities of firms that are most important for growth: investment in capital and productivity improvements.

‘Corporate income taxes appear to have a particularly negative impact on GDP per capita. This is consistent with the previously reviewed evidence and empirical findings that lowering corporate taxes raises total factor productivity growth and investment. Reducing the corporate tax rate also appears to be particularly beneficial for TFP growth of the most dynamic and innovative firms. Thus, it seems that corporate taxation affects performance particularly in industries and firms that are likely to add to growth.’

IMF

‘... corporate income taxes have the most negative effect on growth, followed by labor income taxes, then indirect taxes, and finally property taxes’.

Philip Bazel, Research Associate, University of Calgary and Jack Mintz, President’s Fellow, University of Calgary

‘US tax reform will not only have implications for Australia’s ability to compete for multinational investment, but the positive flow-on effects of investment: technology, jobs and tax revenues.’

Mirrlees Review (UK Tax review)

‘With immobile labour, the effective incidence of the source-based corporate income tax is likely to be borne largely by domestic workers. Lower investment implies less capital per worker and therefore less output per worker, which will result in a lower real wage.’

‘Recent empirical studies have also supported the main prediction of this simple analysis – that higher source-based corporate income taxes are likely to depress domestic real wages.’

Universities of Munich and Mannheim

A recent German study has found that 51% of the burden of company tax falls on workers after analysing almost 18,000 business tax changes in over 10,000 municipalities over 20 years. The study also found that higher corporate taxes reduce the wages of the low-skilled, women and young workers the most.

Source: Dr Martin Parkinson, *Enhancing our living standards through tax reform*, BCA/PwC Tax Reform forum, 11 September 2014; Comment on Day 1 of Tax Forum, 4 October 2011, from the then Secretary of the Treasury, Dr Ken Henry; Joanna Mather, “Tax plan will deliver wages and profits: Chris Richardson”, *AFR*, 13 February 2018; OECD, *Tax Policy Reform and Economic Growth*, 2010; IMF, *Fiscal policy and long-term growth*, 2015; Bazel and Mintz, *Australia’s investment challenge in wake of 2018 US tax reform*, 2018; Mirrlees et al., *Mirrlees Review: Tax by Design*, 2011; Fuest et al. *Do Higher Corporate Taxes Reduce Wages? Micro Evidence from Germany*, ifo working paper, 2017.

Business Council members pay more than 36% of company tax paid in Australia

In relation to terms of reference (b) the Business Council strongly believes that all business in Australia must meet their tax obligations and do so in a transparent way. Where arrangements do not keep pace with community norms, they should be reviewed.

Robust integrity measures are an integral complement to more competitive business tax arrangements, but responding to tax avoidance by delaying company tax cuts would not target the issue and only harm income and jobs growth.

Since 2015 the Australian Taxation Office has published details of tax paid by large companies. Business Council members in total paid \$23 billion of company tax in 2015-16 (the most recent year for which comprehensive data have been published).

While the Business Council welcomes this greater transparency, the data have often been misinterpreted, with some commentators erroneously comparing tax paid and total revenue. Company tax is a capital income tax that is payable on taxable profits not revenues. That is, tax is paid on residual income after all costs, including wages, rent, intermediate inputs and depreciation have been netted out.

As the Commissioner of Taxation has explained, not all businesses would be expected to pay company tax each and every year for a variety of reasons, including the impact of lumpy investments and operating losses over time.

The Business Council has supported greater tax transparency and integrity measures in recent years, including encouraging members to sign the voluntary Tax Transparency Code. Among other things, the Code requires a reconciliation and explanation of accounting profits and taxes paid.

- ▶ Sixty-seven Business Council members have signed the Code, representing more than \$21 billion or one-third of total company tax paid.

Australia's business tax integrity measures are among the most robust

- ▶ Many of Australia's integrity measures have been comprehensively amended over the past few years, with recent changes making our tax integrity system amongst the most robust in the world and better aligned with the OECD Base Erosion and Profit Shifting (BEPS) Project recommendations.
- ▶ Australia is already either compliant or acting on the OECD's BEPS recommendations. Changes announced/enacted over recent years include the Multinational Anti-Avoidance Law; Diverted Profits Tax, country-by-country reporting, a doubling of penalties that apply to large companies who engage in tax avoidance and public disclosure of the tax information of large companies. Changes to hybrid rules were released last month for public consultation.
- ▶ The ATO performs detailed one-on-one reviews of the largest 100 companies, who pay about 40% of all company tax. Extra government funding is enabling the ATO, under the Tax Avoidance Taskforce, to extend these reviews to over 1,000 companies.

► Tax Commissioner Chris Jordan has said company tax compliance in Australia “is around global best practice and many countries aspire to this level of compliance”.

Source: Chris Jordan, Address to the National Press Club, 5 July 2017.

Reducing the company tax rate for all businesses is the top priority for tax reform

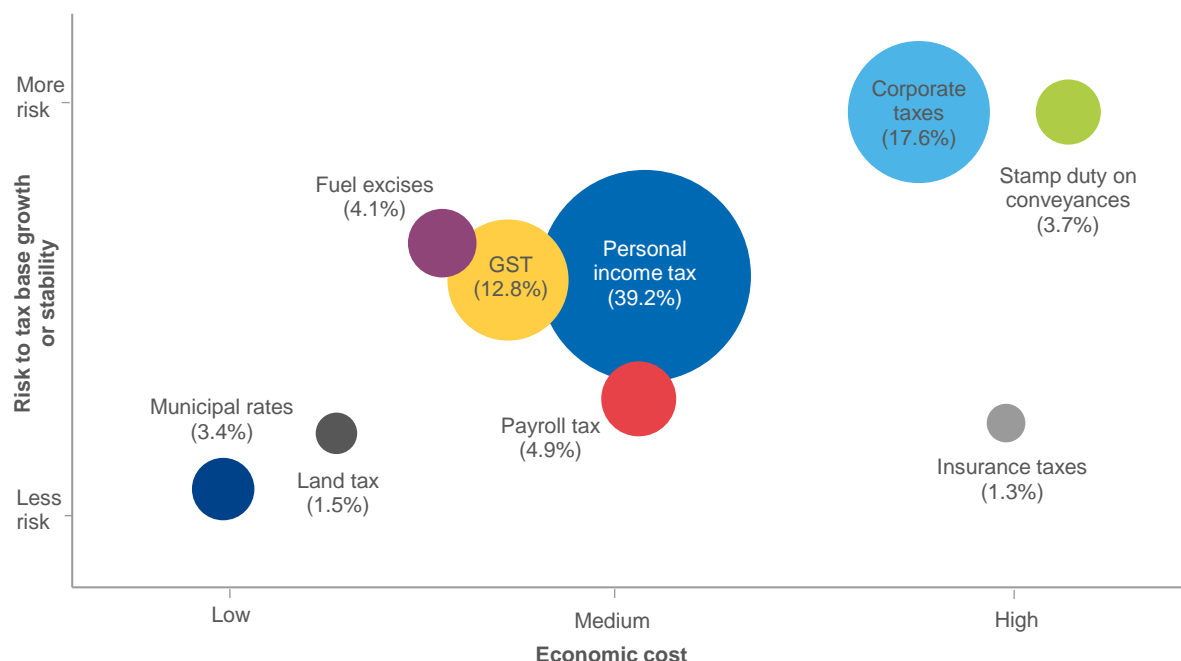
The Business Council has been one of the strongest advocates for broad-based tax reform. In March 2016, the Business Council laid out a comprehensive three-stage plan to achieve growth-enhancing tax reform by 2025 — *Realising Our Full Potential: Tax Directions for a Transitioning Economy*.

Australia needs a mix of taxes that doesn’t overly discourage people from participating in the workforce and being entrepreneurial, and does not unduly penalise businesses from investing, innovating and creating well-paid jobs in Australia. It is vital that broad taxation reform is not shunted from the policy agenda because it is deemed politically difficult.

However, the absence of a broad tax reform agenda should not be used as a reason for delaying any tax reform. Sequencing of economic reforms rarely follows the text book ideal and, indeed, fundamental changes to Australia’s federal taxes will require time and greater fiscal capacity underpinned by stronger growth.

Treasury analysis shows that the 30% company tax rate is high risk in terms of its impact on economic growth and revenues underpinning the budget (Figure 4).

Figure 4: Australia’s high company tax is the most harmful federal tax



Note: Percentage and size of circle shows share of tax revenue in 2013-14.

Source: Roger Brake, *An inside perspective on the Tax White Paper*, 2015.

It is the top priority for tax reform simply because it will deliver the biggest community payoff.

Since 2008, almost two in every three industrialised nations have reduced or are planning to reduce their rates. In this rapidly changing global environment, the government's 10-year plan will barely keep Australia in the game. A company tax rate of 25% in 2026-27 will still be above the current OECD average of 24% and Asian country average of 21%.¹¹

As the rest of the world moves, doing nothing does not mean nothing happens. KPMG Economics estimates that recent US tax reforms could permanently reduce Australia's GDP by at least 0.3% (or \$5.1 billion) and lead to around 25,500 fewer jobs.¹²

The proposed reduction in the company tax rate withstands scrutiny

It's hard to think of another policy proposal that has been subjected to such intense scrutiny as the proposed modest cut in the company tax rate to 25%, phased in over 10 years. If other policy proposals to regulate business or spend billions of taxpayers' dollars received even half as much attention, the Australian economy would be in a much better place.

Yet as outlined in greater detail in Attachment 1, the criticisms do not stand up. Importantly:

- ▶ It is affordable — the plan is factored into the forward estimates and 10-year budget projections, including a return to surplus by 2020-21 (in no small part due to forecast higher company tax receipts which are estimated to reach \$97 billion by 2020-21)¹³
- ▶ Dividend imputation has been fully accounted for in the modelling of the tax cut (and would have similar implications for accelerated depreciation).

From any perspective, one per cent additional GDP in perpetuity is a big deal. The net payoff is large measured against the yardstick of any past or current reforms. It equates to adding an extra \$18 billion to the Australian economy (in today's terms) year in year out. This quickly adds up to a very big number over time. The benefits of a bigger economy flow to Australian workers through higher wages (\$750 a year in today's dollars on average) and more jobs.

What else is on the table right now that would deliver such a large net economic dividend?

But these gains will only be achieved if tax cuts extend to large businesses. Larger companies pay almost two-thirds of company income tax and form the backbone of many industries such as mining and manufacturing, which require large-scale investments.

Higher investment by bigger businesses will also maximise the benefits of the tax cut for small and medium businesses. As COSBOA Chief Executive Peter Strong has observed:

'...at the moment the tax cuts are coming through for businesses that turn over up to \$50 million, which is fantastic, so the people have challenged me and said 'well you've got to be happy, why are you fighting for big business?' Well I don't know if I'm fighting for big business, I'm fighting for small. Because those tax cuts will become meaningless if big business stop investing in infrastructure and stop investing in wage

¹¹ KPMG, Corporate tax rates table.

¹² KPMG, *A global game changer: An analysis of the Trump tax reforms*, 2018.

¹³ Australian Government, *Mid-Year Economic and Fiscal Outlook 2017-18*, 2017.

growth or whatever and start moving offshore. So, it wouldn't take long for that \$50 million to become irrelevant.'¹⁴

Cutting the company tax rate for all businesses does not require a leap of faith. The evidence stacks up. It requires a leap of faith to believe that Australia can continue imposing globally uncompetitive tax settings without serious implications for jobs and incomes.

¹⁴ Peter Strong, Interview with Michael Clarke, ABC North Queensland, 5 March 2018.

Attachment 1: Responding to criticisms

Companies pay a large amount of tax

- ▶ Companies paid \$71 billion of company tax in 2016-17, and paid over \$300 billion over the past five years.¹⁵
- ▶ Company tax is paid on profits not revenue.
- ▶ Profits are calculated after paying all expenses, including wages, supplier costs, investment.
- ▶ Tax Commissioner Chris Jordan declared last year that tax compliance in Australia is 'around global best practice and many countries aspire to this level of compliance'.¹⁶

Company tax cuts will flow through to workers

- ▶ Treasury modelling shows over half the benefits from a tax cut flow to Australian workers and households.¹⁷ This is in line with most modelling on this topic.
- ▶ Australian workers are the biggest winners because increased investment makes them more productive and valuable.
- ▶ Economist Chris Murphy has said 'Whether your main source of income is wages, assets or a benefit linked to wages such as the age pension, you benefit more from a company tax cut than a regular cut to personal income tax or the GST that has the same cost to the government budget.'¹⁸

The estimated benefits of a tax cut incorporate dividend imputation

- ▶ The Treasury modelling accounts for dividend imputation, as does analysis by Independent Economics and KPMG, and all still show a substantial benefit to investment and the broader economy.¹⁹
- ▶ Australia imports capital because its domestic savings are not large enough to support the range of profitable investments, particularly in capital intensive export sectors.
- ▶ Large Australian companies and foreign companies operating in Australia have foreign equity holders who do not benefit from dividend imputation. These investors demand a globally competitive after-tax return on their investments in Australia, otherwise they will invest elsewhere. A lower company tax rate in Australia will expand the range of projects that will meet the after-tax rate of return required by investors.

¹⁵ Australian Government, *Mid-Year Economic and Fiscal Outlook 2017-18*, 2017; Australian Government, *Budget 2017-18*, 2017.

¹⁶ Chris Jordan, Address to the National Press Club, 5 July 2017.

¹⁷ Xavier Rimmer, Jazmine Smith, and Sebastian Wende, "The incidence of company tax in Australia," Treasury Economic Roundup 1 (2014): 33–47.

¹⁸ Chris Murphy, "Company tax cut will build our society, not tear it up", *AFR*, 27 March 2018.

¹⁹ Independent Economics, *Company tax scenario*, prepared for the Department of the Treasury, 2016; KPMG, *Modelling the macroeconomic impact of lowering the company tax rate in Australia*, 2016.

- ▶ Domestic shareholders will not lose out – the company tax rate for domestic equity holders is effectively zero with a 30% tax rate and will continue to be zero with a 25% tax rate. Shareholders will not pay more tax overall, just that the lower amount ‘prepaid’ by the company will be exactly offset by an increase in the amount they pay directly as personal income tax.
- ▶ Overall, domestic shareholders will benefit from higher investment and company earnings over time — and miss out if investments go offshore.

The tax cut is fiscally responsible

- ▶ Company tax revenue will continue to grow from \$71 billion in 2016-17 to \$97 billion in 2020-21.²⁰
- ▶ Commonwealth expenditure on education and health will continue to grow. In 2016-17, the federal government spent \$32.6 billion on education and this will rise to \$37.9 billion in 2020-21. Federal government health spending will increase from \$74.4 billion to \$82.8 billion over the same period.²¹
- ▶ The independent Parliamentary Budget Officer, Jenny Wilkinson has confirmed that ‘The company tax cut has been fully factored into the government’s budget projections—both the forward estimates and budget projections.’²²
- ▶ Those saying we can’t afford it are either ignoring what the modelling is telling them or signaling that they want to spend the money on something else.
- ▶ They misleadingly compare a 10-year budget impact of \$65 billion with a single year of net economic benefit of 1% of GDP (\$18 billion in today’s dollars). The net benefit over 10 years is \$180 billion in today’s dollars.
- ▶ This increase in GDP is twice as big as the lasting economic benefits of the landmark tariff cuts of the 1980s and 90s.²³
- ▶ If opponents can demonstrate a bigger benefit from spending the same amount on something else, then great – but we haven’t seen any analysis of alternatives. The company tax cut has been rigorously and independently modelled.
- ▶ Numerous well-regarded economists and institutions have said that cutting company tax is the highest priority and gives the best return to the community.

²⁰ Australian Government, *Mid-Year Economic and Fiscal Outlook 2017-18*, 2017.

²¹ Australian Government, *Mid-Year Economic and Fiscal Outlook 2017-18*, 2017.

²² Hansard, Senate Finance and Public Administration Legislation Committee, 2017-2018 Additional Estimates, 26 February 2018.

²³ Productivity Commission, *Review of Australia’s General Tariff Arrangements*, Inquiry Report, 2000.

Australia's effective tax rate is high by global standards

- ▶ Tax expert Professor Jack Mintz of Calgary University recently published updated effective marginal tax rates for more than 40 countries, which show that Australia's effective marginal company tax rate is 28.4%, the 7th highest. This is because Australia offers relatively few concessions for capital costs.²⁴
- ▶ The Congressional Budget Office (CBO) report of 2012 data which suggested that Australia's effective rate is low is out of date.²⁵
- ▶ Since 2012, seven countries analysed in the CBO report (Argentina, France, Italy, Japan, South Africa, UK and US) have or plan to cut their company tax rates. Almost all their tax rates were above 30% in 2012.
- ▶ The CBO report is not consistent with tax experts from Oxford University Centre for Business Taxation and the Calgary School of Public Policy whose estimates place Australia towards the top of the pack.
- ▶ The CBO report also recognises the headline statutory rate is what influences corporate behaviour. That's what matters to investment decisions now.
- ▶ The CBO report is an American report written for an American audience. The average tax rate estimates look at the "worldwide income and corporate taxes" of American companies operating in Australia. It doesn't look at all businesses operating in Australia.

We cannot assume foreign investors will ignore Australia's increasingly uncompetitive tax rate

- ▶ Australia is attractive to investors for many reasons, but that doesn't mean we can rest on our laurels. Tax isn't the only factor but a globally competitive company tax rate is one of the most direct and effective levers we have for driving higher investment.
- ▶ Tax changes overseas will change the arithmetic for global investors considering investing in Australia and can only be bad news for Australian workers and businesses.
- ▶ The money and jobs will go elsewhere.
- ▶ The IMF recently confirmed that the US company tax cut will draw substantial investment funds into the US from global markets.²⁶

²⁴ Bazel and Mintz, *Australia's investment challenge in wake of 2018 US tax reform*, 2018.

²⁵ Congressional Budget Office, *International Comparisons of Corporate Income Tax Rates*, March 2017.

²⁶ IMF, *World Economic Outlook Update*, January 2018.

BUSINESS COUNCIL OF AUSTRALIA

42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 www.bca.com.au

© Copyright April 2018 Business Council of Australia ABN 75 008 483 216

All rights reserved. No part of this publication may be reproduced or used in any way without acknowledgement to the Business Council of Australia.

The Business Council of Australia has taken reasonable care in publishing the information contained in this publication but does not guarantee that the information is complete, accurate or current. In particular, the BCA is not responsible for the accuracy of information that has been provided by other parties. The information in this publication is not intended to be used as the basis for making any investment decision and must not be relied upon as investment advice. To the maximum extent permitted by law, the BCA disclaims all liability (including liability in negligence) to any person arising out of use or reliance on the information contained in this publication including for loss or damage which you or anyone else might suffer as a result of that use or reliance.