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Enterprise Tax Plan – Senate Inquiry

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Australian Chamber of Commerce and Industry

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1 Key points

The Australian Chamber supports the Government's Enterprise Tax Plan Bill, particularly the progressive reduction in Australia's company tax rate to 25 per cent for all businesses by 2026-27.

Reducing the company tax rate increases the after-tax return on Australian projects for investors. This boosts investment, which drives higher productivity resulting in stronger profits, higher wages and more jobs. 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 also increases revenue by making it less cost-effective for companies to restructure their operations to avoid paying tax in Australia.

Treasury modelling indicates that reducing Australia's company tax rate from 30 per cent to 25 per cent would boost Australia's national income by 0.6-0.7 per cent, including a 0.4-1.1 per cent increase in take-home pay for workers.[1] This boost in living standards should provide compelling support for the Government's proposed company tax reforms. However, opponents of company tax reform have argued that the results of the Treasury modelling should be disregarded for various reasons. The Australian Chamber's views on these objections are detailed in the remainder of this submission and summarised in the table below.

Table 1 – Summary of objections and the Australian Chamber's responses

Objections by opponents of company tax reform	Australian Chamber's responses
Treasury is right, but…	
The benefits will take too long	If the full 10-year schedule is legislated, the benefits may actually precede the loss of revenue.
Now is not the right time because of budgetary constraints	By the time the majority of the cuts take effect the Budget is expected to be in surplus, with tax as a share of GDP at or above its historical average. Weak business investment in Australia and ongoing reductions in company tax rates overseas provide further reasons to avoid delay.
We should not reward company tax avoidance	Maintaining a high company tax rate actually rewards businesses who engage in aggressive tax

[1] Kouparitsas, M., Prihardini, D.and Beames, A. 2016, 'Analysis of the long term effects of a company tax cut', *Treasury Working Paper 2016-02*.

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	planning because it gives them an advantage over their rivals.
The cuts should only apply to small business	Small businesses (and workers) will benefit most from across-the-board company tax reform.
Treasury is wrong because…	
There is no real-world evidence	This is wrong – empirical studies of aggregate and firm level data show that higher company taxes reduce growth, wages and investment (sources are provided below).
Treasury assumes perfect markets	The model adjusts for economic rents and shows that a benefit remains even with the assumption that investors need a 0.5 per cent premium above the global rate to invest in Australia.
Only foreigners benefit because of dividend imputation	ATO data shows that a large proportion of dividends are not utilised by domestic investors.
Lowering the company tax rate will not reduce profit-shifting	Empirical studies show that lowering the company tax rate reduces profit-shifting because it becomes less cost effective (sources are provided below).
US investors deduct Australian company tax paid from their US tax bill	This only applies to 5 per cent of company tax and is accounted for in the Treasury results.
Other modelling shows a company tax cut reduces national income	Centre of Policy Studies modelling cited by critics has a number of problems. For example, it fails to adjust for profit-shifting or increased workforce participation and the assumption regarding the response of capital is at the bottom of the standard range. A detailed critique is not possible because many of the assumptions have not been published.
The US economy performs well with a high company tax rate	The US has a large number of deductions so company tax as a share of GDP is 2.2 per cent in the US compared with 4.9 per cent in Australia.

2 Objections to company tax cuts and Australian Chamber responses

2.1 Treasury is right, but…

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Some opponents of company tax reform acknowledge the accuracy of the Treasury modelling, but argue that the results should be disregarded.

2.1.1 The benefits will take too long

The Grattan Institute objects on the basis that the loss of revenue from a lower company tax rate would be immediate, whereas the benefits outlined in the Treasury modelling take time to realise, so the effect on national income would be negative for about 10 years.[2]

This concern is addressed by the fact that the Government's proposal is to reduce the company tax rate gradually over a 10-year period, with most of the reduction in revenue concentrated in the final four years.[3] These estimates of revenue forgone are also exaggerated because they appear to ignore the fact that the boost to national income will offset around half the direct reduction in revenue.[4]

Investors make decisions based on expected returns over the life of a project, and projects often take several years to begin generating profits. This means that they are likely to invest in anticipation of a future reduction in the company tax rate provided they believe the promise is credible. In other words, under the Government's approach the benefits of cutting the company tax rate may actually precede the loss of revenue. The windfall gain to existing investors will also be limited as the current capital stock will largely depreciate over the 10-year period.

2.1.2 Now is not the right time because of budgetary constraints

Some have argued that it is not the right time to act because of budgetary constraints.

However, all but a small proportion of the reduction in government revenue from the proposed company tax cut will occur after the Budget is projected to return to surplus. Without tax cuts, by 2020-21 tax as a share of GDP is expected to rise above 23.9 per cent,[5] which is the average level during the boom period of 2000–

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[2] Daley, J. and Coates, B. 2016, *The full story on company tax cuts and your hip pocket*, viewed 22 September 2016, http://grattan.edu.au/wp-content/uploads/2016/05/The-full-story-on-company-tax-cuts-and-your-hip-pocket.pdf#page=5.
[3] Parliamentary Budget Office 2016, *Not the time for tax cuts*, viewed 22 September 2016, https://d3n8a8pro7vhmx.cloudfront.net/melbourne/pages/7403/attachments/original/1464779182/86_Not_the_time_for_tax_cuts.pdf?1464779182#page=7.
[4] Independent Economics 2016, *Company tax*, viewed 22 September 2016, http://www.independenteconomics.com.au/Company.aspx.
[5] Parliamentary Budget Office 2015-16, *2015-16 Budget: medium-term projections, Projected receipts*, viewed 22 September 2016, http://www.aph.gov.au/~/media/05%20About%20Parliament/54%20Parliamentary%20Depts/548%20Parliamentary%20Budget%20Office/Reports/02_2015%202015-16%20Budget%20-%20Medium-term%20projections/201516%20Budget%20medium-term%20projections%20-%20Chapter%202.pdf?la=en.

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01 to 2007–08. The average tax-to-GDP ratio over the past 40 years is just 22 per cent.[6]

There are also other reasons to avoid delays on company tax reform. Currently weak investment growth (both in mining and non-mining industries) is the biggest drag on Australia's economic performance. Additionally, other advanced economies (with the notable exception of the US for reasons discussed below) generally have much lower company tax rates than Australia. Further delays are likely to make Australia's company tax rate even more uncompetitive.

2.1.3 We should not reward company tax avoidance

A common argument is that the Government should not cut the company tax rate while multinationals continue to structure their operations to avoid attributing profit to jurisdictions with high tax rates.

However, maintaining a high company tax rate actually rewards businesses who engage in aggressive tax planning because it gives them an advantage over their rivals. The businesses that pay the most tax will be the biggest losers if the proposed tax cuts do not proceed and competitive pressures mean they will slowly lose market share, leading to a steady increase in profit-shifting.

International evidence suggests that cutting the company tax rate is an effective way to reduce profit-shifting as it makes the practice less cost-effective.[7] Australian and international efforts are also being taken to address company tax avoidance directly.

2.1.4 The cut should only apply to small business

The idea that Government should only legislate the company tax cut up to a particular point if the legislation is unable to pass in its entirety has been raised in the media on several occasions.

The Australian Chamber has previously noted that the vast majority of company tax is paid by the largest companies. Legislating only part of the package would also undermine the benefits of the glide-path approach outlined above. Businesses have been dealing with uncertainty about company tax reform for almost a decade and it is time for action.

Legislating only part of the Enterprise Tax Plan 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. The UK was a jurisdiction that had a two-tier

[6] Potter, M. 2016, 'The case against tax increases in Australia: the growing burden', *Centre for Independent Studies*, Research Report 15, available https://www.cis.org.au/app/uploads/2016/06/rr15.pdf#page=12.
[7] De Mooij, R.A. 2005, 'Will Corporate Income Taxation Survive?', *De Economist,* vol. 153, no. 3, pp. 277-301, pp.17-18.

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company tax system for many years. However, this operated as a marginal rate system and was ultimately abolished.

Most Australian Chamber members are small businesses, but everything is connected. International investors have lots of options and if Australia is uncompetitive they will invest their money elsewhere. Local workers and businesses will lose out if a factory closes or a new mine is not built.

2.2 Treasury is wrong because…

Many opponents of company tax reform claim the benefits calculated by Treasury are inaccurate.

2.2.1 There is no real-world evidence

Some have claimed that the results of the Treasury modelling should be ignored because they are not substantiated by empirical evidence.[8] However, there is a long list of empirical studies examining the effects of company tax.

For example, a study by an OECD economist using data from 21 OECD countries from 1970 to 2005 found that reliance on company tax to raise revenue was damaging to a country's GDP per capita.[9] Another study focusing on provincial tax rates in Canadian provinces from 1997 to 2006 found that 1 percentage point cut in the company tax rate led to 0.1-0.2 percentage point increase in annual growth rates.[10] An analysis of historical data from the US finds an even stronger result, with a 1 percentage point cut in the average corporate income tax rate raising real GDP per capita by 0.4 to 0.6 per cent after one year.[11]

In relation to the effect on wages, a study of 55,000 firms over nine countries from 1996 to 2003 found a $1 increase in company tax reduced a company's wage bill by 49 cents in the short-run and 64 cents in the long-run. An analysis by a US Federal Reserve economist of country-level data from 19 countries from 1979 to 2002 found that a 1 percentage point increase in the marginal company

[8] Richardson, D. 2016, 'Company tax cuts: what the evidence shows', *The Australia Institute,* available http://www.tai.org.au/sites/defualt/files/P245%20Company%20tax%20-%20what%20the%20evidence%20shows.pdf.
[9] Arnold, J. 2008, 'Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries', *OECD Economic working papers no. 64,* available http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=eco/wkp(2008)51.
[10] Feredeand, E. and Dahlby, B. 2012, 'The impact of tax cuts on economic growth: evidence from the Canadian provinces', *National Tax Journal*, vol 65, no. 3, pp 563-594, available https://www.ntanet.org/NTJ/65/3/ntj-v65n03p563-94-impact-tax-cuts-economic.pdf.
[11] Mertens, K. and Ravn, M.O. 2013, 'The Dynamic Effects of Personal and Corporate Income Tax Changes in the United States', *The American Economic Review*, vol. 103, no. 4, pp. 1212-1247.

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tax rate decreases annual wages by 0.7 per cent, meaning that the decrease in wages is more than four times the amount of company tax revenue collected.[12]

In relation to investment, a Treasury summary of an OECD survey on the effect of company tax on foreign direct investment (FDI) found that a one percentage point increase in the rate of tax would reduce FDI by 3.72 per cent.[13]

2.2.2 Treasury assumes perfect markets

People are often sceptical of modelling because they believe that it relies on unrealistic assumptions about perfect markets. However, these concerns are explicitly addressed in the Treasury modelling.

Treasury acknowledges that investment to capture above-average returns driven by location-specific factors will not be affected by company tax because those returns cannot be captured elsewhere. Treasury accounts for this by calculating the normal rate of return based on the average rate of return over the past 20 years. Treasury then uses detailed industry data reported in ABS Estimates of Multifactor Productivity to estimate that location-specific factors account for just over 5 per cent of GDP or around 14 per cent of business gross operating surplus.[14]

Treasury also addresses concerns that capital is not perfectly mobile. In line with economic theory and standard modelling practices, the baseline model assumes that in the long run international capital will flow into a country until the risk-adjusted rate of return is consistent with the global rate of return (i.e. capital is perfectly mobile). However, Treasury finds that reducing the company tax rate will improve Australia's national income even if investors require a 0.5 per cent premium above the global rate of return to invest their money in Australia.

2.2.3 Only foreigners benefit because of dividend imputation

Some argue foreigners benefit from a reduction in Australia's company tax rate because domestic investors receive personal tax credits through the dividend imputation system.

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

[12] Alison Felix, R. 2007, 'Passing the Burden: Corporate Tax Incidence in Open Economies', *Federal Reserve Bank of Kansas City Regional Research Working Paper RRWP 07-01*.
[13] The Australian Treasury 2008, 'Architecture of Australian's Tax and Transfer System', p 292, available http://taxreview.treasury.gov.au/content/downloads/report/architecture_of_australias_tax_and_transfer_system_revised.pdf#page=292.
[14] Kouparitsas, M., Prihardini, D.and Beames, A. 2016, 'Analysis of the long term effects of a company tax cut', *Treasury Working Paper 2016-02* and De Mooij, R.A. 2005, 'Will Corporate Income Taxation Survive?', *De Economist*, vol. 153, no. 3, pp. 277-301, pp.17-18.

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.

2.2.4 Lowering the company tax rate will not reduce profit-shifting

Some are sceptical that lowering the company tax rate will reduce profit-shifting because Australia's company tax rate will still be uncompetitive compared to the tax rates that apply in many other jurisdictions.

However, creating structures that allow profit to be distributed to low-tax jurisdictions is costly. Aggressive profit-shifting also involves a degree of risk as the exact legal boundaries can be an issue of judgement. Lowering the company tax rate reduces the benefits of profit-shifting and makes companies less likely to take on these costs and risks.

The effect of lowering the company tax rate on profit-shifting included in the Treasury modelling is based on overseas empirical evidence.[15]

2.2.5 US investors deduct Australian company tax paid from their US tax bill

The Australia Institute has argued that the effect of lowering the company tax rate on investment will be muted by the fact that US investors can credit tax paid in Australia against their tax liability in the US.[16]

However, this issue only applies to 5 per cent of company tax revenue and is fully accounted for in the Treasury modelling.[17]

2.2.6 Other modelling shows a company tax cut reduces national income

Opponents of company tax reform often argue that reducing the company tax rate will boost GDP but reduce national income, citing modelling from the Centre of Policy Studies (CoPS) at Victoria University.[18] The CoPS modelling suggests that most of the benefit would go to foreign investors, at the expense of domestic investors and government revenue.

Many of the details of the CoPS model are not published, so it is difficult to fully explain why it differs from the Treasury modelling, but critiques have been

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[15] Kouparitsas, M., Prihardini, D.and Beames, A. 2016, 'Analysis of the long term effects of a company tax cut', *Treasury Working Paper 2016-02*.
[16] Richardson, D. 2016, 'Company tax cuts: what the evidence shows', *The Australia Institute,* available http://www.tai.org.au/sites/defualt/files/P245%20Company%20tax%20-%20what%20the%20evidence%20shows.pdf.
[17] Independent Economics 2016, *Company tax*, viewed 22 September 2016, http://www.independenteconomics.com.au/Company.aspx.
[18] Dixon, J.M. and Nassios, J. 2016, 'Modelling the Impacts of a Cut to Company Tax in Australia', *Centre of Policy Studies Working Paper No. G-260*, available http://www.copsmodels.com/ftp/workpapr/g-260.pdf.

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published by Murphy[19] and Nash and Rynne.[20] Some of the issues raised in these critiques are noted below.

A key problem is that the CoPS modelling ignores the benefit of increased workforce participation (driven by higher wages) and reduced profit-shifting. The CoPS modelling does examine the effect of increased investment, but the size of the effect is at the very bottom of values used in the international literature. Another problem is that the CoPS modelling assumes that the level of franking credits claimed by Australian shareholders matches the amount of company tax they pay, but utilisation is less than half that amount.

When different models provide different results it can be difficult for non-experts to know which set of results to believe. This issue should be resolved by facilitating a collaborative discussion between the respective modellers, or opening both models to scrutiny by an independent expert.

2.2.7 The US economy performs well with a high company tax rate

Some have argued that having a high company tax rate cannot be too damaging for the Australian economy because the US has one of the highest company tax rates in the world.

However, due to a large number of deductions, in 2013 (the most recent year with data for both countries) company tax as a share of GDP was 2.2 per cent in the US compared with 4.9 per cent in Australia.[21]

3 About the Australian Chamber

The Australian Chamber of Commerce and Industry speaks on behalf of Australian business at home and abroad.

Our membership comprises all state and territory chambers of commerce and dozens of national industry associations. Individual businesses also get involved through our Business Leaders Council.

We represent more than 300,000 businesses of all sizes, across all industries and all parts of the country, making us Australia's most representative business organisation.

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[19] Murphy, C. 2016, 'The effects on consumer welfare of a corporate tax cut', *ANU Working Papers in Trade and Development, No. 2016/10*, available https://acde.crawford.anu.edu.au/sites/default/files/publication/acde_crawford_anu_edu_au/2016-05/2016-10_cmurphy_company_tax3.pdf#page=26

[20] Nash P and Rynne B, 2016, 'Basic economics tell us company taxes are too high and uncompetitive', *Australian Financial Review,* 15 April 2016, available http://www.afr.com/opinion/basic-economics-tell-us-company-taxes-are-too-high-and-uncompetitive-20160414-go6ab0

[21] See OECD.stat https://stats.oecd.org/Index.aspx?DataSetCode=REV

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The Australian Chamber strives to make Australia a great place to do business in order to improve everyone's standard of living.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We also represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

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