Business Council of Australia

SUBMISSION

# Submission to the Senate inquiry into the Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016

**SEPTEMBER 2016**

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## Key points

- The Business Council recommends the Senate pass the Enterprise Tax Plan Bill without amendment to lay foundations for future growth.
- Australia is falling behind in the global contest for new investment. We cannot ignore the reality that we operate in a global economy. We are fooling ourselves if we think that we can opt out of it. We simply have to remain competitive to attract investment.
- Business investment is a core driver of economic growth and prosperity.
  - Businesses invest to expand their operations, to build new factories and plants, to buy state-of-the-art machinery and equipment and to develop and adopt cutting edge technologies.
  - Investment drives higher output and more efficient production. It increases business revenues and profits (and taxes), leads to more people being employed and increases output per worker which allows higher wages to be paid.
- Even with record low interest rates, Australia has an investment problem. Private business investment has fallen substantially over the past three years. The last time it was falling as fast was during the early 1990s recession.
- Resurgent business investment will be essential for future economic growth, higher-paying jobs and higher living standards across the country, particularly in regional areas.
- Tax isn't the only factor but a globally-competitive company tax rate is one of the most direct and effective economy-wide policy levers we have for driving higher investment. Other countries know this and have been reducing their company tax rates while we have stood still. Australia now has the 6th highest company tax rate in the OECD compared with 16th highest in 2001. It is currently 5 percentage points above the OECD average.
- This 5 percentage point gap matters. Businesses have to make choices about where to invest their next dollar and our high tax rate means that more and more investments at the margin are not made in Australia. Losing investment means that we are all made considerably poorer.
- Cutting company taxes for all businesses must be one of the highest and most urgent priorities for reform.
- The Enterprise Tax Plan Bill proposes to narrow the gap between Australia's company tax rate and today's average OECD rate of 25 per cent over 10 years.
- While the proposal is careful and modest, locking in the 25 per cent rate for all businesses by 2026-27 will send a credible and positive signal that reorientates the dynamic in favour of investing in Australia.
- Higher investment will make the economic pie grow – a 25 per cent rate is estimated to increase GDP permanently by around 1 per cent or $16 billion per year in today's terms.

## Key points (cont'd)

- A pay-off of this size is large by any reform standard. There are substantial *net* community benefits, year in year out, after accounting for all the costs including revenue impacts.
  - Comparing the 10-year revenue impact against a single year of net economic benefit is erroneous and misleading.
- The benefits are widely shared. It is not a case 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.
- A more competitive company tax rate will also shore up our narrowing and volatile corporate revenue base. It is estimated that more than half the revenue impact would be recouped, delivering higher revenues across all levels of government.
- Economic growth is the best way to make the revenue base sustainable.
- Restricting the tax cuts to smaller businesses would mean missing out on the bulk of the investment gains and barely improve our global competitiveness.
  - Larger companies pay two-thirds of company income tax and form the backbone of many industries such as mining and manufacturing, which require large-scale investments. They support thousands of regional jobs and small local suppliers. Larger companies are the main driver of Australia's employment growth.
  - Permanently locking in a two-tier company tax system would entrench perverse incentives for businesses to inefficiently structure their businesses for tax purposes.
  - Small businesses would also benefit most from across-the-board cuts through better economic conditions and because small and big businesses depend on each other. Business Council research indicates that the activity between businesses small, medium and large is worth around $520 billion a year.
- Cutting the company tax rate for all businesses does not require a leap of faith. The evidence stacks up. It is a leap of faith to believe that Australia can continue imposing globally uncompetitive tax settings without serious consequences.
- Implementing the Enterprise Tax Plan will not crowd out other worthwhile reforms. This is a phony choice. We should be pursuing any reform that delivers demonstrable net community benefits.
- If this reform is rejected, what else is going to be done to improve the competitiveness of the private sector which accounts for 80 per cent of our economy and jobs?
- Choosing not to pass this Bill in its entirety would be a decision to let Australia fall further behind other countries and give up on competitiveness and building future prosperity. It would be a decision to continue imposing self-inflicted harm on the Australian economy, workers and households. We cannot afford *not* to pass this Bill.

## Australia is in a global contest for investment

Australia is a small, open economy. We depend on commerce with the rest of the world to generate higher living standards.

With a relatively small population, we do not save enough to finance all worthwhile investments, particularly in our capital-intensive export sectors. We rely on foreign investment to boost our own investment capacity.

We are having to compete for funds in an increasingly contested global market. Investors have choices about where next to invest their marginal dollar.

### We need to lay foundations for future growth

Our economy is at a critical juncture. It is in a process of transition from the mining construction boom and record high terms of trade. Economic indicators are patchy and the outlook remains uncertain.

- While year-on-year real GDP growth of 2.9 per cent in 2015-16 is reasonably strong, GDP growth per person of 1.5 per cent remains well below the pre-GFC 10-year average growth rate of 2.2 per cent.
  - Mining exports are playing a large role in Australia's current growth – the payoff from past investment.
  - But new private business investment has been falling and has detracted from growth.
- In 2015-16, business profits as measured by the ABS fell by 1 per cent, following a 3 per cent fall the previous year.
- Wages grew just 2.1 per cent over 2015-16, the slowest in 18 years.
- Labour market outcomes have been mixed – the unemployment rate has fallen to its lowest level in three years, but the so-called underemployment rate is at record highs.

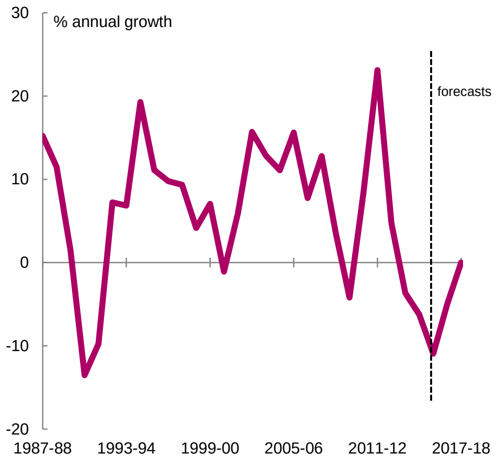
With current growth being underpinned by past investments rather than new investment, the question is where will future growth come from? Strong investment in both traditional and new industries will be needed to sustain long-term economic growth and living standards. Large-scale investment will be needed in industries including agriculture and agribusiness, gas and mining as well as manufacturing to seize opportunities in global supply chains.

## Australia has an investment problem

Private business investment is a corner stone of economic prosperity. Investment is about expanding operations, building new plants, buying machinery and equipment and introducing new technology in order to produce more goods and services more efficiently. This process generates jobs and drives higher output per worker which, in turn, drives real wages growth.

Private business investment in Australia currently is very weak, having fallen substantially over the past three years. The last time business investment was falling this fast was during the early 1990s recession.

**Figure 1: Business investment is falling at rates last seen in the 1990s recession**




**Source: ABS, Australian National Accounts, cat. no. 5206.0.**

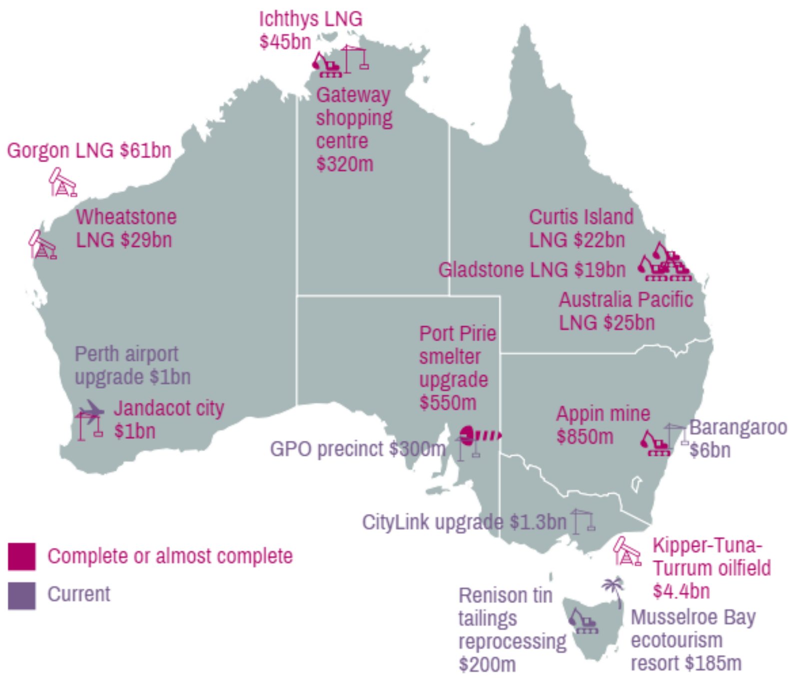
## Australia is missing out on global investment

Capital has become increasingly mobile and global investment flows are at their highest since the GFC. Australia is missing out, with overseas investment into Australia falling from $US40 billion to $US22 billion last year – a 45 per cent fall. It is currently at its lowest level since 2003. Australia ranked 17th highest as a destination for foreign investment in the world– down from sixth just three years ago (United Nations, 2016; Uren, 2016).

While the fall in Australia reflects the winding down of the mining investment boom, the decline has been larger than for other resource-exporting countries. For example, Canada and Brazil experienced much smaller declines in overseas investment, falling by 17 per cent and 11 per cent respectively (United Nations, 2016).

This has real on-the-ground implications for Australia's economic growth. Mega mining projects across regional Australia are now complete or wrapping up and by comparison, projects in the investment pipeline are generally of a much smaller scale.

Australia faces an investment pipeline of smaller scale projects




**Source: Deloitte Access Economics, *Investment Monitor*, 2016.**

Low business investment especially impacts regional economies. In Queensland, mining investment has fallen from $31 billion in 2013-14 to $10 billion 2015-16 (ABS, 2016e). Mining employment in Queensland has fallen 25 per cent from its peak, with around 20,000 jobs lost (ABS, 2016d). This has important flow on effects for local regional communities and small businesses. For example, while the unemployment rate for the greater Brisbane area is 5.6 per cent, this compares with an unemployment rate of 6.6 per cent for the rest of the state (ABS, 2016c).

Without a turnaround in private investment it is difficult to see higher growth being sustained.

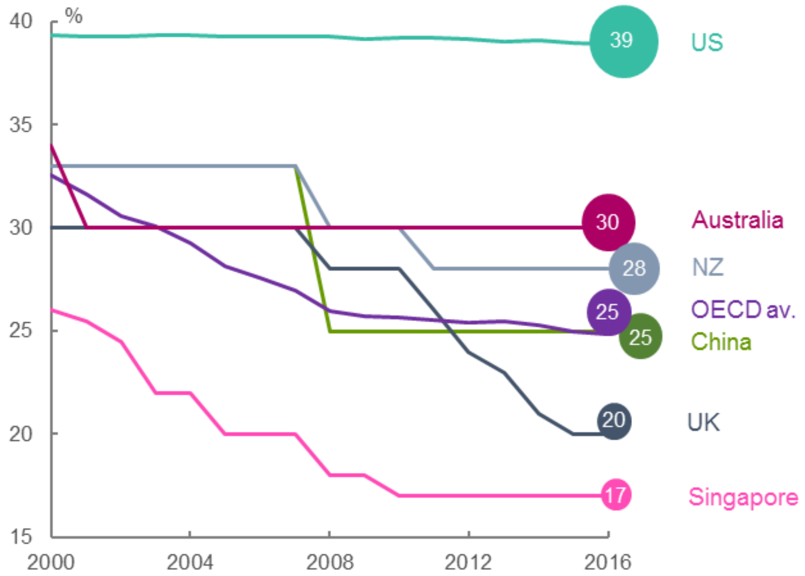
> 'The way to create more jobs is to grow the economy. Given that 80 per cent of our economy is driven by business and private enterprise, by far the biggest lever is to encourage business to increase investment thereby leading to job creation.'
>
> Richard Goyder, CEO, Wesfarmers, *The Australian*, 9 June 2016

## Competitive company taxes are critical for future investment and growth

Investment decisions reflect a range of factors, many of which are not amenable to policy action. But company tax rates directly affect investor rates of return and are one of the most direct and effective policy levers we have for influencing investment decisions.

Australia's materially higher company tax rate seriously detracts from the business case for investing in Australia. The statutory rate of 30 per cent competes with an average of 23 per cent in Asia and 25 per cent across the OECD.

**Figure 2: Australia stands still while competitors reduce rates further**




**Source: OECD, *Tax Database*, 2016; KPMG, *Corporate Tax Rates Table*, 2016; KPMG, *Corporate and Indirect Tax Rate Survey*, 2007.**

Australia used to be ahead of the pack. In 1993 when Australia lowered the company tax rate to 33 per cent, our tax rate was 4.6 percentage points lower than the OECD average. By 2001 when we lowered our rate to 30 per cent other countries had caught up and our tax rate was only 1.6 percentage points lower than the OECD average. By standing still, Australia now has the 6th highest rate in the OECD and our rate is now 5 percentage points *above* the OECD average.

Company tax rates overseas are continuing to fall. Two in three OECD countries have reduced their company tax rates since 2006 (OECD, 2015).

Without the passage of this Bill, Australia's company tax rate will become even more uncompetitive, driving investment, innovation and jobs abroad. The UK government announced in the 2016 budget that the UK company tax rate will be dropped further to 17 per cent by 2020. The government had previously legislated that the rate would fall to 18 per cent by 2020.

Reducing the US company tax rate to 15 per cent is featuring in the US presidential election. If the US were to lower its company tax rate, this would intensify the imperative for Australia to act merely to remain competitive in a global market for capital. This is because the US would become a more attractive investment destination for all investors, compared with Australia.

### High company taxes deter investment and growth

Australia's company tax rate matters because investors and businesses have choices about where to invest globally. Of course tax is not their only consideration, but a high company tax rate is an important factor that affects decisions at the margin, making Australia a less attractive investment destination.

> 'A more competitive corporate tax rate would enable Australia to attract valuable investment in advanced manufacturing and in turn convert its world leading R&D into fully-fledged industries located in Australia, according to CSL Limited, Australia's largest biotechnology company… [these conclusions] are underpinned by CSL's own experience in deciding where to locate a A$500 million plant to manufacture synthetic and enhanced versions of the body's own blood clotting agents. CSL chose Switzerland before Australia although a large share of the foundation R&D for these highly sophisticated products was undertaken by CSL in Australia.
>
> A range of factors, including for example, proximity to market, availability of staff with relevant regulatory and market experience and favourable industrial relations, influenced CSL's decision. But corporate tax rates were undoubtedly significant and the effective tax rate available in Switzerland is substantially lower than that of Australia.'
>
> CSL media release, 15 June 2015

The investments we lose mean that our economy is smaller and we are all less well off. Treasury (2015) estimates that raising an extra dollar of company tax imposes a real cost on the economy of around 50 cents, reflecting the value of marginal investment forgone. This means 50 cents is irretrievably lost for every additional dollar of company tax raised.

More recent analysis by Dr Chris Murphy (2016) finds a much larger figure – more than $2.00 lost for every additional dollar of company tax raised.

> **Making company taxes more competitive has had bipartisan support**
>
> 'We know the company tax rate is a significant drag on growth, largely because capital is more footloose than labour …'
>
> Dr Andrew Leigh, Fairfax Breaking Politics, 14 September 2015
>
> 'It's a Labor thing to have the ambition of reducing company tax because it promotes investment, creates jobs and drives growth.'
>
> Chris Bowen, Hearts and Minds: A Blueprint for Modern Labor, 2013
>
> 'Today capital is even more mobile than it was then and it is important that our corporate tax rate is competitive.'
>
> Chris Bowen, Hearts and Minds: A Blueprint for Modern Labor, 2013

The bottom line is that our 30 per cent company tax is a highly inefficient way of raising revenue – we make ourselves substantially poorer by raising an extra dollar of company tax. This makes cutting company taxes for all businesses one of the highest priorities for reform.

### Australian workers, not companies, bear the brunt of uncompetitive company taxes

By reducing investment, high company taxes mean that output per worker and real wages are lower than they could be. In turn this means that the ultimate *incidence* of the company tax largely falls on workers, not owners of capital who can shift investments around the globe. It is estimated that up to two-thirds of the company tax is borne by labour.

This is why lowering business taxes primarily benefits Australian workers. Additional capital equipment results in better equipped, more productive workers, enabling higher real wages. This isn't just theory. Output per worker (labour productivity) has been the main driver of higher real wages in Australia over time.

**Australian workers will be the biggest winners**

'any improvement in Australia's living standards must be driven by a higher level of labour productivity…a company income tax cut can do that…the long-term benefits accrue to workers and households via permanently higher after tax wages and consumption.'

The Treasury, *Analysis of the long term effects of a company tax cut*, 2016

'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 Martin Parkinson, as Secretary of The Treasury, 11 September 2014

'… 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**. They would be the principal beneficiaries.'

Dr Ken Henry, comment on Day 1 of Tax Forum, 4 October 2011

## Confining tax cuts to smaller businesses would severely limit the economic benefits

### Australia needs successful small, medium and large businesses and they need each other

Businesses differ in size for many reasons including the size of the market, the benefits of internal cooperation and coordination, economies of scale, capital intensity and the age of the firm. Exporting firms are often larger and successful firms typically grow over time. If we want successful businesses they need to be encouraged to grow to their optimal size.

Large businesses play a crucial role in the Australian economy through innovation, job creation and exporting. For example:

- together Wesfarmers and Woolworths employ around 370,000 people
- the four largest banks employ 120,000 people
- our two major domestic airlines together employ around 40,000 people.

Large businesses also play a critical role supporting small businesses as both buyers and suppliers. Small businesses need big businesses to be successful – and vice versa. For example, Wesfarmers (2016) paid its suppliers more than $45 billion last year.

**More than half of all new jobs are in large businesses**

- Around 10 million people are employed in the private sector overall.
- Department of Industry research estimates that between 2006 and 2011 just over 1 million additional full time equivalent (FTE) jobs were created.
- Small and medium businesses added 480,000 FTE jobs while large businesses created 560,000 more FTE jobs.

**Small and large businesses need each other**

- Business Council research indicates that the activity between businesses small, medium and large is worth around $520 billion a year.

Luke Hendrickson et. al., 'The employment dynamics of Australian entrepreneurship', September 2015

Tim Reed, CEO, MYOB:

'We have surveyed small and medium-sized enterprises (SMEs) and the results show a majority believe lowering the business tax rate for all of Australia's businesses is important for the success of their own business, and because it will help make Australia's economic pie bigger.'

Tim Reed, CEO, MYOB, *The Daily Telegraph*, 3 June 2016

### A 25 per cent company tax rate for all businesses will significantly increase economic prosperity and living standards

The proposed cuts in company taxes for all businesses over the next 10 years to 25 per cent will significantly boost investment leading to higher output, real wages and job opportunities.

**What a 25 per cent company tax rate could do for a manufacturing company**

Company A is looking to invest $200 million in a new manufacturing plant and the board has set a 10 per cent rate of return for the investment to go ahead reflecting the riskiness of the project. Under a 30 per cent company tax rate the project has a 9 per cent 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 per cent, the project would have an 11 per cent 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 per cent 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 Company A's manufacturing plant, so the board has set a hurdle rate of 15 per cent. Under a 30 per cent company tax rate the rate of return is 14 per cent so the project cannot fully recoup its cost of capital. However, under a 25 per cent company tax rate the project is expected to make $70 million in today's terms. The rate of return is now 16 per cent. Because the project is now profitable, it will proceed.

**What a 25 per cent company tax rate could do for an advanced manufacturer**

Company B 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 per cent company tax rate compares with a rate of 25 per cent in Australia. The project is expected to make $80 million (a 13 per cent rate of return) if it goes ahead in New Zealand, or $110 million if it goes ahead in Australia (a 14 per cent rate of return). As a result, if the company tax rate falls to 25 per cent, Company B will build the plant in Australia rather than New Zealand.

The proposed cuts will also 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.

In short, lower business taxes will permanently increase the size of the economic pie that can be shared across the community.

Modelling by Treasury and various professional consultants indicates broadly similar impacts.

Using plausible and realistic assumptions about the place of the Australian economy in global capital markets (essentially that Australia is not large enough to materially affect global rates of return), the models consistently show significant real income gains from making Australia's business taxes more competitive. (Outlier model results showing negative income effects rely on unrealistic assumptions about Australia's capacity to affect global rates of return.)

Treasury (2016) modelling estimates a permanent 1 percentage point increase in GDP once the full tax cuts flow through to investment. In today's dollars, this translates to an additional $16 billion in economic activity and about $4 billion additional government revenue. This additional revenue can be used to fund spending, tax cuts or to reduce the deficit. Real wages increase by 1.2 per cent ($8.5 billion or the equivalent of more than 100,000 full-time jobs paying average wages).

These estimates assume that the tax cuts are fully offset by either tax increases or spending cuts, so there is no revenue shortfall.

New investment and new technology and innovation typically go hand in hand. New technology will bring additional productivity benefits that will increase GDP and real wages. Unfortunately the models cannot capture these important benefits, but the OECD (2010) believes they are significant and provide yet another reason why competitive business taxes are crucial for stronger growth.

### The majority of the benefits comes from larger businesses

Most of these economic gains come from extending the tax cuts to larger businesses. This is because companies with turnover above $100 million account for around two-thirds of company tax paid. This reflects factors such as the scale of their investments.

**Table 1: A small number of large companies account for total tax paid in 2013-14**

| Turnover | Companies | Companies, % | Net tax, $b | Net tax, % |
|---|---|---|---|---|
| Less than $2 million | 811,129 | 91.4% | 7.7 | 11.6 |
| $2-10 million | 58,212 | 6.6% | 6.9 | 10.3 |
| $10-100 million | 15,623 | 1.8% | 8.6 | 12.8 |
| $100-250 million | 1,299 | 0.1% | 3.4 | 5.0 |
| $250 million or more | 1,086 | 0.1% | 40.3 | 60.3 |
| **Total** | **887,349** | **100.0%** | **66.9** | **100.0** |

**Source: ATO Taxation Statistics 2013-14.**

The benefits of the Government's tax plan progressively build over time as the tax rate is further reduced and lower rates are extended to more and more businesses and investments.

### Locking in future tax cuts will bring forward investment

But we will not have to wait ten years before significant gains are realised. 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.

Modelling of the timing of the benefits of the Bill has not been undertaken, however there are related relevant studies. KPMG (2016) modelled a 5-year phased reduction from 30 to 25 per cent starting from 2018-19, with over half the gains estimated to accrue by the time the cut was fully phased in. The UK Treasury (2013) modelled the timing of the gains from the 5-year phased reduction in the UK's company tax rate from 28 to 20 per cent. It estimated over half the gains would accrue by the time the cut was fully phased in.

**The distortions created by a two-tier company tax system must not become entrenched**

The Business Council has always opposed differential company tax rates because of the added complexity and potential to distort investment by discouraging businesses from expanding.

For example, consider a company with a taxable income (profit) of $600,000. If the company has revenue of $1,999,999, it will pay tax at the 28.5 per cent rate, or $171,000 of tax. However, if the company made this profit on revenue of $2 million or more, it will pay tax at the 30 per cent rate, or $180,000 of tax. This extra $9,000 in tax represents an enormous marginal effective tax rate. Such tax 'cliffs' encourage structuring of operations for tax rather than commercial purposes.

The two-tier company tax system also distorts the dividend imputation system because there will be an increasing number of companies with a 27.5 per cent tax rate, compared with a 30 per cent rate in the previous year. However, companies may pay tax in one year but pay dividends in a later year under different company tax rates. The Bill proposes a solution to this distortion while the annual aggregated turnover threshold is increased. The solution may reduce the value of some franking credits and increase complexity.

Under the proposed legislation the distortions arising from a two-tier company tax system will eventually be removed by 2023-24, when the annual aggregated turnover threshold is abolished. It is critical that the Bill is passed in full so the increased distortions and complexity do not become a permanent feature of the tax system.

> 'Meanwhile lowering the corporate rate for smaller businesses only…creates an artificial incentive for Australian businesses to downsize.
>
> In worse case scenarios some businesses might actually lay people off to get smaller - and the size based different tax treatment would create a glass ceiling on business workforce growth.
>
> Instead we want a level playing field regardless of the size of the company.'
>
> Bill Shorten, Australian Council of Social Services National Conference, 20 March 2011

**Multinational tax avoidance should be addressed but retaining an uncompetitive company tax rate is not the solution**

The Business Council believes companies must meet their tax obligations and 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.

Australia has 'some of the strongest tax integrity rules in the world' (Australian Government, 2015). These laws have been recently tightened (or changes have been announced), including to better align Australia with OECD Base Erosion and Profit Shifting

(BEPS) Project recommendations. Australia is already either compliant or acting on the OECD's BEPS recommendations.

Recent measures include the introduction of country-by-country reporting, the Multinational Anti-Avoidance Law, the Diverted Profits Tax, changes to hybrid and transfer pricing rules, the establishment of the Tax Avoidance Taskforce in the Australian Taxation Office (ATO), a doubling of penalties that apply to large companies who engage in tax avoidance, public disclosure of the tax information of large companies, the Tax Transparency Code, improved whistle-blower protection and a hundredfold increase in penalties for large companies which do not adhere to tax disclosure obligations.

Revenues from these measures will be realised as changes are enforced. There is also a risk in overstating the potential revenue gains from tax avoidance measures. Chris Jordan, Commissioner of Taxation, speaking about revenue to be raised from companies in dispute with the ATO, said 'our best estimate is that it would be more than hundreds of millions of dollars and less than billions of dollars – perhaps up to $1 billion' (Hewett, 2016).

## The case for company tax cuts is solid

There has been a great deal of commentary questioning the benefits of cutting company taxes especially for larger businesses. Not one of the arguments stacks up.

### Company tax cuts are funded and affordable

The Enterprise Tax Plan is estimated to reduce revenues by $48 billion over a decade against company tax collections of $1.1 trillion over the period. The cut therefore represents just 4.3 per cent of corporate tax revenue, or 0.8 per cent of all Commonwealth revenue, over this time (Minerals Council of Australia, 2016).

The proposed tax changes are fully funded over the next four years. Beyond that the budget is projected to return to surplus factoring in the tax cuts.

This is hardly fiscal recklessness. It is instead a responsible and proportionate adjustment to the uncompetitive business tax burden.

As Professor John Freebairn observes:

> 'Granted a net revenue cost, the case for lowering the corporate tax rate rests on reducing one of the more distorting and inefficient taxes. Increases in other less distorting taxes and reducing government expenditure are potential offsetting funding options to maintain budget balance.' ('Who benefits from a Lower Corporate Income Tax Rate?', www.austaxpolicy.com, 2016)

### The revenue conundrum: a more competitive tax rate will shore up revenue sustainability

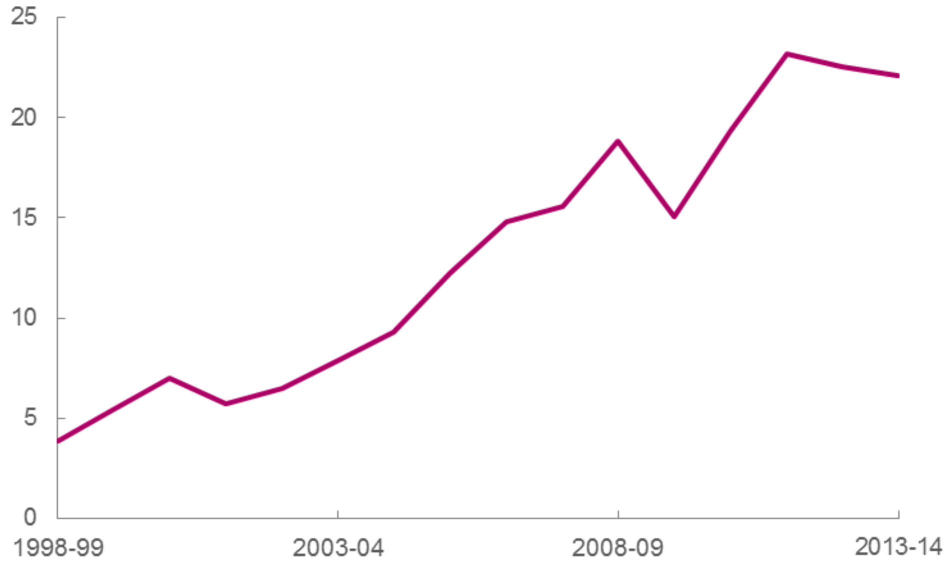
Not proceeding with the Enterprise Tax Plan because of its revenue impact would be short-sighted and counterproductive.

In the longer term, Independent Economics (2016) estimates that more than half of the revenue impact will be recouped, which delivers higher revenues across all levels of government.

A more competitive company tax rate will help shore up long-term sustainability of corporate revenue base increasingly reliant on a relatively small number of taxpayers.

Company taxes will generally rise with stronger profits because they tax profits. To the extent that profits growth slows, company tax growth will likely slow as well. The tax paid by the 12 largest taxpayers increased significantly over the past decade. In 2013-14, the 12 largest taxpayers paid around one-third of all company tax – over $20 billion. However, profits growth has slowed recently and along with it taxes paid. The company tax base has become increasingly sensitive to the profitability of relatively few companies.

**Figure 3: Tax paid by the 12 largest companies has eased as profits have flat-lined**




**Source: Business Council calculation using Heferen, Future of the Income Tax, 2015; ABS, Taxation Revenue, Australia, 2014-15, cat. no. 5506.0; ATO, Corporate Tax Transparency, 2015.**

Economic growth is the b way to make the revenue base sustainable. So we should not assume that corporate tax levels as a share of the economy will suddenly plummet when the rate comes down.

Our rate has come down 19 percentage points in the last 30 years, but corporate tax collections are much higher as a proportion of GDP today. It demonstrates the great success of Australian businesses and the dividends that flow from backing business.

Since 2010 the UK government has lowered the company tax rate from 28 per cent in 2010 to 20 per cent today, simultaneously reducing the deficit from 10.3 per cent of GDP to 3.8 per cent (HM Treasury, 2016).

### Australian workers, not foreign multinationals, will benefit the most

The biggest winners from higher investment are Australian workers, not shareholders, because increased investment makes them more productive and valuable.

In the short term, foreigners with existing investments in Australia may receive a transitory gain from a lower company tax rate. This is because they have made investments in the expectation of paying the existing 30 per cent tax rate. But this temporary increase in after-tax returns is absolutely necessary as it is what attracts increased investment.

But as investment expands, after-tax returns will return to their pre-tax cut levels. Any transitional gain for existing investors will be moderated by the phasing in of the rate reduction.

### The big banks will not pocket billions of dollars

Australia's banks will not pocket billions of dollars. This is because of dividend imputation.

In 2015 the banks paid $9.5 billion in company tax and $18 billion in dividends to shareholders. If they had faced a 25 per cent company tax rate, their tax bill would have been around $1.5 billion lower. Less tax paid by the company would reduce franking credits on dividends paid. Shareholders pay personal income tax on unfranked dividends.

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.

**A tax cut for Australian companies is not a free kick to the US government**

The US levies taxes on the profits of overseas subsidiaries when these profits are repatriated to the US. Companies receive a credit in the US for taxes paid overseas.

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.

**Even with interest rates at record lows, company tax rates are far from irrelevant**

Some argue that if companies aren't already increasing investment in response to historically low interest rates, a tax cut won't help. This is not the case.

Global uncertainty and lower producer prices have increased the risk premium demanded by investors everywhere. But reducing Australia's tax rate will make investing in Australia *relatively* more attractive and induce a positive investment response.

**The benefits are large and worth having by any measure**

Claims that the economic pay-off is small relative to the revenue cost compare apples and oranges.

For a start, they often compare a 10-year budget impact of $48 billion with a one year net economic benefit of $16 billion.

In addition, the modelled annual payoff of $16 billion is a *net* benefit, after taking into account the costs of raising offsetting taxes. It is a measure of the increase in the size of the pie.

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.

### Company tax cuts are not 'trickle down' economics

So-called trickle-down economics characterises unbalanced growth that favours the wealthy and privileged, and where those who are less well-off may eventually reap some small benefit when the rich spend their increased wealth.

There is nothing ‘trickle down’ about the impact of company tax cuts.

It is better characterised as a rising sea. Workers are the biggest beneficiaries from a direct and substantial lift in real wages. It is true that the full benefits take time to flow through, but that is the case for any economic reform that triggers investment responses, including investments in education where the benefits accrue over a person’s entire lifetime.

The fact that benefits take time is not an argument for not undertaking a reform. It is an argument for implementing the reform as soon as possible to bring forward the benefits.

> ‘Whenever an idea is ventured publicly by a person, whether that person is a policy advisor or whether it's a government minister, there's at least a handful of academics who will contest it.’
>
> ‘I've seen it on both sides of politics - this is not a partisan comment at all - but for governments, government ministers who are seeking to get ideas legislated - it is unbelievably frustrating, incredibly frustrating.’
>
> ‘But I think there are occasions on which economists might, at least for a period, put down their weapons and join a consensus.’
>
> Dr Ken Henry, quoted in P. Martin, ‘Back the tax, Henry tells economists’, SMH, 22 June 2010

### Modelled estimates of benefits are consistent and robust across a range of assumptions

There has been much debate about modelling of the impacts of company tax cuts. Models by definition present stylised representations of the economy. Results inevitably vary reflecting differences in assumptions used, model data and theory.

But small differences in results do not undermine the critical insight that under a range of plausible assumptions, cutting company taxes will increase investment in the Australian economy. This increase in investment in turn drives higher real wages and higher national income.

Importantly, the results are robust to a range of reasonable assumptions. The modelling accounts for dividend imputation, foreign tax credits and imperfectly competitive domestic markets.

The most critical underlying assumption is that Australia is a small, open economy, highly reliant on foreign capital, and operating in a competitive global market. Assuming this is not the case flies in the face of reality.

**Company tax cuts need not and should not be at the expense of other worthwhile reforms**

There is absolutely no reason why other worthwhile reforms should be delayed because of company tax cuts – or vice versa.

All policies that deliver demonstrable net community benefits ought to be pursued to ensure that we get the greatest value from our scarce resources.

In particular, the Business Council outlined the need for phased, transformative tax reform in *Realising Our Full Potential: Tax Directions for a Transitioning Economy* (attached).

## Attachment A: Large businesses are central to our economy

Around 10 million people are employed in the business sector overall. Department of Industry research estimates that between 2006 and 2011 just over 1 million more full time equivalent (FTE) jobs were created. More than half of these or 560,000 FTE jobs were in large businesses (Hendrickson et al., 2016).

- Together Wesfarmers and Woolworths employ around 370,000 people.
- The four largest banks employ 120,000 people.
- Our two major domestic airlines together employ around 40,000 people.

Together the private sector contributes 80 per cent of economic output. Large business contributed $460 billion worth of goods and services to the economy in 2014-15 or around 40 per cent of total output.

### Large companies are vital for mining

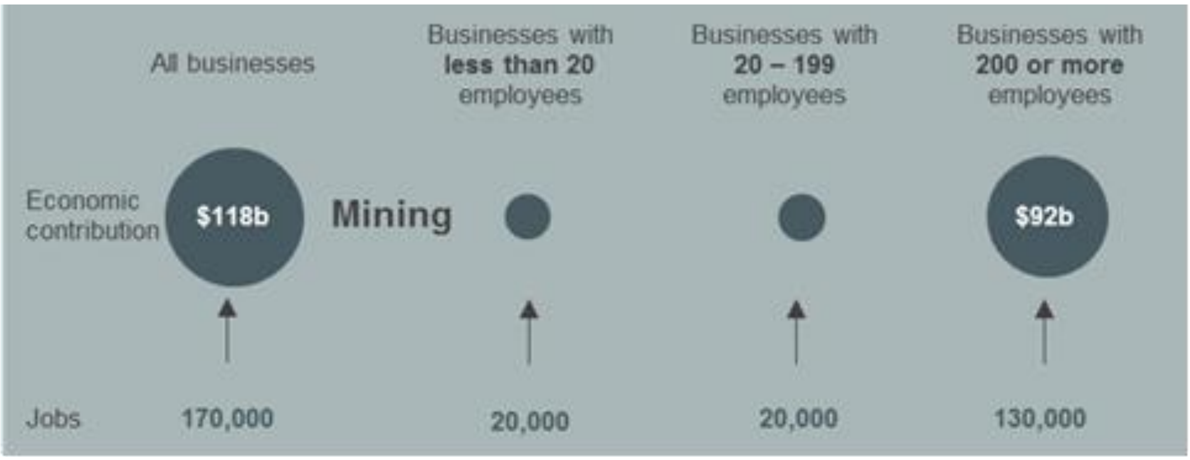
Australia could not have reaped the benefits of providing raw materials to rapidly growing parts of Asia without large mining companies.

Extracting resources is generally a large-scale, capital intensive activity. Enormous up-front investment is typically required to make extraction possible and profitable. Investments can run into the tens of billions before product can be sold or exported. Such large-scale investment and extraction require large businesses.

The structure of the mining industry reflects the comparative advantages of large firms. Large mining businesses produce over $90 billion for the economy each year and employ 130,000 people, many of whom live in regional Australia. These large operations also support many smaller suppliers across a range of industries including manufacturing and professional and technical services such as engineering.

There are also substantial revenue flows from major projects. Royalties to state governments, particularly in WA and Queensland, have been able to fund government activity across the state.

**Figure 4: Large mining companies are vital to the sector**




Source: ABS, Australian Industry, 2014-15, cat. no. 8155.0.

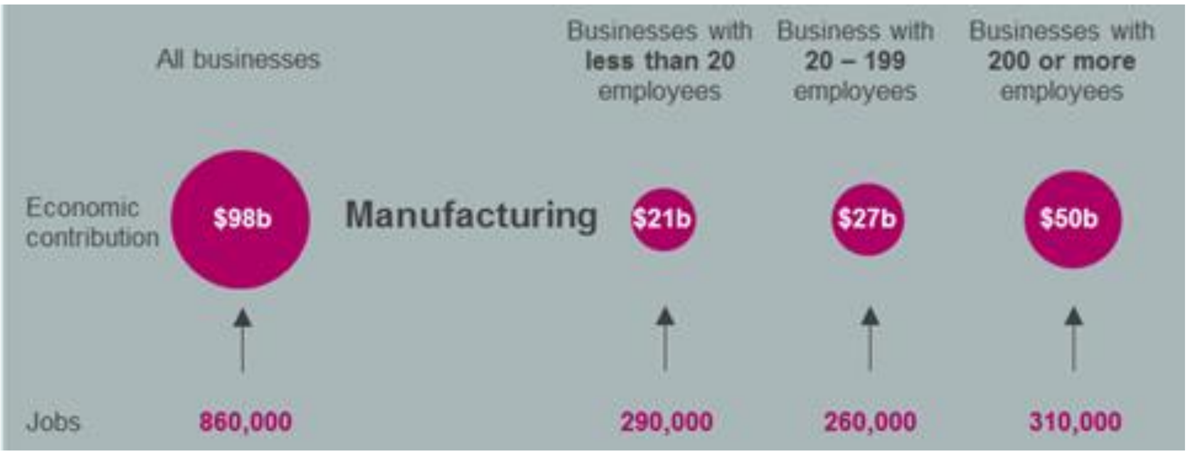
### Large companies are the backbone of the manufacturing sector

Australia's manufacturing sector includes a mix of small firms with niche products and larger scale businesses.

Large manufacturing plants can produce goods using sophisticated technology at significantly lower cost than small ones, bringing productivity benefits. For example, large European manufacturers are 30 to 40 per cent more productive than small firms with fewer than 10 employees.

Large manufacturing businesses produce $50 billion for the economy each year and employ 310,000 people.

**Figure 5: Large manufacturers are as important as SMEs**




**Source: ABS, Australian Industry, 2014-15, cat. no. 8155.0.**

### Large scale agrifood businesses will be needed to grow our exports

Global demand for high-quality food is set to increase dramatically, driven by massive economic change in Asia. There is an opportunity for the Australian agrifood sector to become the preferred source of high-quality, safe and premium food for the growing markets in our immediate region while continuing to serve domestic markets.

But significant investment is required in technology, capacity, and human and financial capital necessary to innovate, compete and to grow. ANZ (2012) has estimated that $1 trillion of investment is needed by 2050 in the sector.

Large scale agribusinesses will be a vital part of this transformation of the sector. Large scale businesses can produce premium goods using sophisticated technology at significantly lower cost than a small ones. They have the scale to go global and take risks when testing new markets. For example, large farms make sales worth $20 billion each year, around half of all agricultural sales.

### Figure 6: Large farms make around half of all agricultural sales


**Source: ABARES, Distribution of farms by total receipts, 2013-14.**

### How large Australian companies would respond to a lower company tax

Changing the company tax rate would enable all companies to invest in Australia. For a large company this may mean a new project and new employees to design, build and run the project.

> Alan Joyce, CEO, Qantas:
>
> 'In reality, the country as a whole has a lot to gain from large companies getting a tax cut – which, to be honest, is the only reason governments would risk suggesting one.
>
> Every time Qantas weighs up a decision to invest in something new (like a new airport lounge, for instance) we run a detailed analysis on the numbers to make sure it's something that will ultimately make money for us. The amount of company tax we have to pay forms part of that analysis – so logically, a lower company tax rate will increase how often we say yes to new investment.
>
> To stick with the same example, the decision to build a new lounge brings a lot of jobs with it – in designing it, through buying the materials required, construction, and ultimately stocking and running it. So it's not hard to see the relationship between a lower tax rate and overall job growth and economic activity.'
>
> Alan Joyce, CEO, Qantas, Herald Sun, 22 June 2016

Richard Goyder, CEO, Wesfarmers:

'Coles announced that over the next two years, we will invest $120m in 10 supermarkets in Western Australia, creating 2,000 new jobs and potentially serving thousands of new customers. These decisions are only made when that new investment makes a suitable return for our shareholders.'

'Two of the biggest disincentives to investment are high taxes and the cost of over regulation.'

'People who trivialise the impact lower business taxes would make clearly don't understand how investment decisions are made in the real world. Put simply, lowering business tax will improve the return on a proposed future investment, thereby increasing the likelihood it will be made.'

Richard Goyder, CEO, Wesfarmers, *The Australian*, 9 June 2016

'If there was a cut in tax, that means on any project we're looking to invest in, the after-tax returns will be higher. Therefore, the hurdle, if you like, for us to invest is lower. So, likely we'd invest more money in either new stores or new plants or acquisitions. Otherwise it'll go to our shareholders and they're pretty good at spending money and efficient at spending money and that's good for the economy as well.'

Richard Goyder, CEO, Wesfarmers, ABC 7.30 program

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BUSINESS COUNCIL OF AUSTRALIA
42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 **www.bca.com.au**