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Senate Standing Committees on Economics
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Dear Committee,

Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016

The Corporate Tax Association (CTA) welcomes the opportunity to make a submission in relation to the *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016* (the Bill) and the supporting Explanatory Memorandum (the EM).

The CTA is the key representative body for major companies in Australia on corporate tax issues. With 116 member companies, the CTA membership provides significant insights into the operation and effect of the company tax system on corporates and their decisions to invest. CTA members account for over $830 billion in gross turnover and $27.5 billion in income tax payable or approximately 70% of all company tax payable by corporations with turnover of greater than $100 million. A list of CTA members can be found at Appendix 1.[1]

The focus of this submission is in relation to the changes outlined in Chapter 1 "Reducing the corporate tax rate" of the EM that accompanied the Bill including the consequential amendments, notably in relation to imputation. We do however provide observations in relation to other changes in the Bill (the tax discount for unincorporated small business and the increase in the small business entity threshold) at the end of this submission.

In summary the CTA is fully supportive of the proposed corporate rate reduction and believe the proposed phasing-in of the rate reduction is a sensible and balanced approach to deal with the initial impact on the rate reduction on government finances.

Chapter 1 of the EM - Reducing the corporate tax rate

Tax Cuts are an efficient means for increasing jobs and growth

As is mentioned in the EM, there is significant theoretical and empirical evidence that shows that while company tax is paid by companies, the burden of taxation is passed on shareholders, consumers and employees (through lower real wages) and that lower company tax would encourage higher levels of investment in Australia for the benefit of all stakeholders. As mentioned at paragraph 1.13 of the EM, the benefit of a reduction in company tax to 25% is estimated to lead permanent increase in GDP over 1% in the long term. It should be noted that is equivalent to a permanent $16.7 billion[2] increase in the size of the economy at current GDP levels, and should be larger by the time the rate reduction is fully implemented by 2026. As Treasury modelling shows this is driven by a 2.7% increase in investment, resulting in a 1% increase in real wages, that would not otherwise arise.[3] Other internal Treasury prepared reports and reports prepared for Treasury have drawn similar conclusions.[4]

Whilst there are subsequent reports prepared by others that have been critical of the conclusions drawn in the Treasury analysis, it is clear, even assuming all the criticisms in relation to some of the Treasury reports are valid, a reduction in the company tax rate is still favourable to the economy and Australian workers in particular.[5]

Our corporate rate is high by international standards

Apart from the academic literature and analysis on the economic benefits of a tax cut, it should not be ignored that the Australian corporate headline rate of 30% is higher than the OECD average of 25% and that only five countries have a higher headline rate[6] at that these countries are in fact exporters not importers of capital like Australia. Moreover, Australia places a heavier reliance on corporate tax collections than most other countries at 4.9% of GDP, with only Norway having corporate taxes as a percentage of GDP higher than Australia. According to the OECD, Norway's tax figures include Petroleum Income tax (the equivalent of Australian Petroleum Resource Rent Tax). Norway's headline corporate rate is in fact 28%, and removing petroleum income tax to ensure a more meaningful comparison, would make Australia the most heavily reliant economy on corporate income tax in the OECD as a percentage of GDP.

It cannot be emphasized enough that our high headline rate sends a very strong message about Australia not being "open for business" and that we have a reticence to create an environment that is conducive to increased investment. The reality is investment decisions do take into account post tax rates of return on investment, albeit they do not drive those investment decisions. This is particularly the case for investment that may not be dependent on the location of a mineral deposit or petroleum reservoir, but rely more on human capital, ideas or innovation as the source of wealth creation. In our view Australia's future prosperity will need to rely more on the latter as the source of future growth than we have done in the past, making it even more important to have policy settings that encourage activity to come to, or remain in Australia, as well as not impacting the traditional drivers of economic growth such as the mining or oil and gas industries.

We are a small open economy

The reality is Australia is a net importer of capital and reducing company tax improves our international competitiveness. Based on data from the Centre of Business Taxation at Oxford University, Australia's ranking would improve from 35th to a middle ranking 23rd among a broad group of 46 countries through a reduction in the corporate rate to 25%[7]

The impact of the budget bottom line is modest

Treasury has estimated that the proposed cuts will cost the revenue some $48 billion over ten years and according the EM the budgetary cost of all three measures is $5.3 billion over the forward estimates.[8] We understand that Treasury estimates have been derived by including the first round impact of the tax cut and an estimate of potential impacts of increased tax attributed to tax that is "clawed back" through the imputation system as dividends would be franked at the lower corporate rate of 27.5% (and eventually 25%). As such the estimates do not fully take into account all second round impacts. We note that some analysis performed for Treasury indicates that even after taking account of the "claw back", corporate tax cuts are 55% self-funding meaning the real impact on budget outcomes in the longer term will be significantly lower.[9]

Tax cuts should not be limited to small corporates

Some have suggested that if a company tax cut is warranted, it should be limited to smaller companies as large multinational are involved in tax avoidance. Whilst there have been reports and parliamentary enquiries in the recent past in relation to alleged tax avoidance by multinational companies, the Australian Taxation Office (ATO) has on numerous occasions made the point that the majority of large corporates pay the right amount of tax.[10] Whilst there is no information publicly released on the ATO's view of the size of the "tax gap" at present, indications are this is significantly lower than the amounts that have been claimed in reports and press releases by certain public advocacy groups. The Committee may wish to consider consulting with the ATO on its views as to the source and size of the tax gap as part of their deliberations.

The reality is Australia's current tax integrity and transparency laws (and those that have been proposed) are some of the strongest in the world. Australia has in many ways led the charge in relation to the G20/OECD BEPS agenda. We have attached as Appendices 2 and 3 a list of the most recent and proposed changes to the tax and transparency regimes that apply in Australia to large companies that provide evidence of action being taken to ensure our rules are robust and companies are transparent in their tax affairs.

We also note that the ATO has been given additional resources in the 2016-2017 budget with the establishment of the Tax Task Force to focus on those that are engaging in sharp tax practices.[11] In our view an approach which includes the current robust tax and transparency rules complemented with a well-resourced ATO are the best means to deal with cases of alleged tax avoidance. Denying tax cuts to the vast majority of corporate taxpayers who are doing the right thing, investing to create jobs and paying their fair share of tax, is a blunt instrument when a targeted response at those involved in unacceptable tax avoidance activities is available and has been funded in recent budget outlays.

Cutting the corporate tax rate is not a race to the bottom

Some have argued that cutting the corporate tax rate as countries compete for investment dollars is a destructive race to the bottom and that Australia is in fact fueling a "slow burn" by giving a corporate rate cut. In the CTAs' view this is completely misplaced as the current proposal is a 10 year phase in of company tax cuts bringing Australia in line with OECD averages, not to rates at levels in other countries such as Singapore, Ireland or the UK.

Dividend imputation does not mean that a tax rate reduction is a zero sum gain

It has been claimed by some that the dividend imputation system operates such that the rate of company tax is irrelevant to investment decisions as dividends are eventually taxed at the investors marginal rate at least for resident investors. This is misleading. The reality is post tax returns are critical to investment decisions and ignore the fact that non-resident investors do not benefit from the imputation system and that corporates do not pay out all retained profits to shareholders as franked dividends.

ATO data indicates that franking credits claims represent 30% of company tax collections, which indicates significant post tax profits are retained by companies and used to fund future activities.[12] In fact the level of franking credits retained as at 30 June 2014 was $296 billion and the balance has increased on average over the 2009 to 2014 years by $19 billion per annum.[13] Reducing the company tax rate should, all other things being equal, lead to more retained profits being available to fund future investment activity rather than companies having to rely on other sources of funding such as tax deductible debt adding stress to balance sheets and potentially impacting share prices.

A rate cut does not mean the US treasury is a beneficiary

Some commentators have argued that due to the operation of the US foreign tax credit rules, any reduction in Australian tax means US headquartered companies end up paying more US tax on the same profit and that one of the main beneficiaries of the tax cut is thus the US Treasury at the expense of Australia.[14]

This concern is misplaced. Firstly, approximately 72% of inbound investment into Australia comes from countries outside the US and US investment into Australia is both in the form of portfolio and non-portfolio (being holdings greater than 10%) investment. It is only non-portfolio investment that could theoretically benefit. Secondly, US tax rules only tax foreign sourced profits from active business once those profits are repatriated and there seems significant evidence to suggest US companies do not repatriate foreign sourced profits.[15] Thirdly, current proposals for US tax reform from both sides of US politics are proposing rules to encourage the repatriation of foreign sourced profit by reducing the US tax rate on these profits to below the proposed 25% Australian tax rate, so there will in fact be no incremental US tax if these reforms are implemented and profits repatriated.

Imputation Consequential Amendments

With the reduction in company tax rate, there are implications to the operation of the dividend imputation system. As is mentioned at paragraph 1.67 of the EM, under the imputation system when an Australian resident company distributes its profits to its members, it has the option of passing on to those members a credit for income tax paid by the entity on the profits by being able to frank distributions calculated by reference to the standard corporate tax rate of 30 per cent. Thus with a constant company tax rate, profits earned in earlier years or the current year can be franked at 30%. In order to deal with the transition to a lower company tax rate, rules are proposed to alter the amount dividends can be franked by reference to the prior year level of aggregated turnover. These rules seem a sensible method to deal with the transition to a lower tax rate in circumstances where all company profits are paid out as a franked dividend in a subsequent year. The reality is however, at least in the context of large publicly listed companies, not all prior year profits are paid out as a franked dividend as companies adopt dividend payout ratios based on their capacity to pay and the need to fund future expenditure via retained earnings rather than potentially by borrowing. The effect of this is therefore many companies have retained earning with franking account balances that have been accumulated while the tax rate is 30%. [16]

The EM indicates at paragraph 1.77, when the company tax rate of 27.5% will apply to all entities (and subsequently reduce to 25%) that the maximum frankable rate will be effectively limited to 27.5% (and eventually 25%). As mentioned above, in circumstances where all prior year profits are paid out as a dividend, this seems the correct outcome as shareholders will pay tax at their relevant marginal rate less the company tax paid, however, where dividends are sourced from years where profits were taxed at 30%, this effectively results in franking credits being "trapped" in the company unless the company starts to derive more income that is exempt in its hands (such as dividends from certain foreign operations).

The implication of this is that there will be a significant incentive for companies to pay out all retained profits prior to the change in the corporate rate to avoid wasting the credits as to do otherwise will result in an effective permanent cost to shareholders, as the tax can never be claimed as a credit. In our view, a better way to manage the tax rate reduction in such circumstance is to continue to allow corporates the ability to frank their dividends to the 30% rate until such time as its 30% franking credit balance is fully utilized. This could possibly be managed by quarantining a 30% franking account and the establishment of other franking accounts that could trace tax paid to the respective income year, and allow corporates the ability to frank dividends at the requisite tax rate from that account or allowing companies to continue to frank at the 30% rate until the 30% franking balance is exhausted.

Other Changes in the Bill

The CTA fully supports the changes outlined in:

- Chapter 2 – Increase to the tax discount for unincorporated small businesses and
- Chapter 3 – Increase in the small business entity threshold.

We do note however that in relation to the tax discount for unincorporated entities, the rate of small business income tax offset applying in the 2026-27 and later years is 16%, which is said to be the relationship between the discount and the company tax rate at that stage.[17] Although marginal, it is suggested that this discount rate should be 17% being the amount rounded to the nearest whole percentage (being 5% divided by 30% or 16.67%).

We also note that retaining the $1,000 cap for offset does appear inequitable, particularly as the full 25% company tax rate is not operative until 2026-27 and later years. In our view, some consideration should be given to, as a minimum, indexing the $1,000 offset to take into account the impact of inflation.

Yours sincerely

Paul Suppree
Corporate Tax Association

Appendix 1

Corporate Tax Association Members

AGL Energy
Alcoa of Australia
Allianz Australia Insurance
AMP Services
Anglo American Metallurgical Coal
ANZ Banking Group
Asciano
Aurizon
Australia Post
Australian Pharmaceutical Industries
Australian Unity
BAE Systems Australia
Bank of Queensland
Barrick Gold
Bendigo & Adelaide Bank
BHP Billiton
Billabong
Bluescope Steel
BOC
Boral
BP Australia
Brambles Industries
British American Tobacco
Brookfield Infrastructure
Caltex Australia
Carlton and United Breweries
Chevron Australia
CIMIC Group
Cleanaway Waste Management
Coca-Cola Amatil
Cochlear
Coffey International
Commonwealth Bank
Computershare
ConocoPhillips
CSL
CSR
Deutsche Bank
DuluxGroup
EBOS Group
Elders
Ergon Energy
ExxonMobil
Fairfax Media
Fletcher Building Australia
Ford Australia
Fortescue Metals Group
Frasers Property Australia
GE Capital Finance
George Weston Foods
Glencore Australia
GrainCorp Operations
Hastings Deering
HSBC Bank
Iluka Resources
INPEX Australia
Insurance Australia Group
Jacobs Group
James Hardie Industries
Japan Australia
Jemena
John Holland Group
Landmark Operations
Latitude Financial Services
Lend Lease Corporation
Linfox
Lion
Macquarie Bank
McMillan Shakespeare
MMG
National Australia Bank
NBN Co
Nestle Australia
Newcrest Mining
Newmont Asia Pacific
News Corp
Norske-Skog
Nufarm Australia
Olbia
Orica Australia
Origin Energy
OZ Minerals
Pepper Group
Powercor
PTTEP Australasia
Qantas
QBE Insurance
Quadrant
Rio Tinto
SA Power Networks
Santos
Scentre Group
Schneider Electric
Seek
Servcorp
Shell Australia
Sigma Pharmaceuticals
SingTel Optus
South32
Stockland Development
Suncorp Group
Tabcorp Holdings
Telstra
Thales Australia
Toll Holdings
Transurban Group
Treasury Wine Estates
Vicinity Centres
Village Roadshow
Viva Energy
WCL Management
Wesfarmers
Westpac Banking
Woodside Energy
Woolworths
Zurich Financial Services

Appendix 2

Recent Australian Tax Integrity and Tax Disclosure Measures

	Measure	Effective Date	Summary of Change
1	General Anti-avoidance	Schemes entered into after 16 November 2012	Strengthening of the definition of tax benefit
2	Multinational anti-avoidance law	From 1 January 2016	Prevent the artificial avoidance of permanent establishments
3	Thin capitalisation	1 July 2014	Reduction in safe harbour debt limits from 75% to 60% for Non Banks and from 95% to 90% for Banks of Australian Assets.
4	Transfer Pricing	For years ending 30 June 2014	Substantial changes to modernise Australian rules to accord with contemporary OECD standards. Requirement for contemporaneous documentation to support positions taken otherwise significant penalties imposed.
5	Country by Country Reporting	For tax years commencing on or after 1 January 2016	Requirement to file country by country reports, including master and local files with the ATO in accordance with OECD requirements
6	Tax Transparency Code	May 2016	Implementation of tax transparency code for large corporations,
7	Public tax disclosures	From the 2014 income tax year	ATO to annually publish tax data for taxpayers with over $100m turnover of income, taxable income and tax paid (including PRRT)
8	Filing of general purpose financial statements	For tax years commencing on or after 1 January 2016	Requirement to lodge general purposes financial statements with the ATO
9	Tax Exchange of Information Agreements	Various	TEIAs to enable ATO access to information from 36 non treaty country tax administrators, including countries such as Cayman Islands, Luxembourg & Bermuda,
10	Reportable tax positions	From the 2014 income tax year	Taxpayers to disclose to the ATO tax positions taken that are not reasonably arguable
11	Revised International Dealings Schedule	From the 2012 income tax year	Modernisation of related party tax disclosures to the ATO, including details of all related party transactions

Appendix 3

Proposed Tax Integrity Measures for Large Corporate Taxpayers

	Measure	Effective Date	Summary of Change
1	Anti–hybrid rules	1 January 2018 or six months after the hybrid mismatch legislation receives Royal Assent.	Adoption of OECD standards to ensure no double non taxation or double deductions for certain hybrid instruments and structures
2	Updated OECD transfer pricing rules	Proposed to apply as from 1 July 2016	Australia to adopt revised OECD BEPS transfer pricing guidance into Australia's tax laws
3	Diverted Profits Tax	From 1 July 2017	40% tax on certain transactions with lower tax jurisdictions to ensure tax is paid in where activities of economic substance reside.
4	100-fold increase in late lodgement penalties	Yet to be announced	A 100-fold increase in penalties for late lodgement of approved forms with the ATO.
5	Increase in false and misleading statements penalty	Yet to be announced	A 100% increase in penalties for false or misleading statements.
6	Revised reportable tax positions	For income years commencing after 1 July 2016	Revised filing requirements for certain transactions that are subject to certain ATO Tax Alerts

End Notes

1 Approximately 75% of CTA membership is Australian headquartered groups with 25% foreign headquartered groups

2 See ABS GDP data at www.abs.gov.au/...

3 For the purposes of this submission, the predominant reference to Treasury modelling is the report prepared for Treasury by Independent Economics "Company tax scenario" dated 28 April 2016. See: www.treasury.gov.au/....

4 See for example the KPMG Report "Modelling the macroeconomic impact of lowering the company tax rate in Australia" dated 2 May 2016 at: www.treasury.gov.au/...

5 We note the Australian Institute is critical of the Independent Economics methodology arguing that a proportion of the increased tax revenue relies on what it calls a "morality dividend" or the fact that a lower tax rate in Australia will lead to less incentive to profit shift to low tax countries. Regardless of that criticism, even if it was wholly correct, ignoring the called morality dividend still creates significant gains in GDP in the long term. See: www.tai.org.au/...

6 USA (35%), Belgium (34%) Japan (33%), France (33%) and Italy (31%).
See www.home.kpmg.com/...

7 See Independent Economics report, page 18.

8 $2.65 billion is attributed to the rate reduction, $450 million to the changes to the small business offset and $2.18 billion for changes to the small business entity threshold.

9 See Independent Economics report, page 3.

10 See for example press release dated 20 September 2016 at www.ato.gov.au/...

11 Additional ATO funding of $670 million is given over the forward estimates and is expected to raise $3.7 billion over this period.

12 See Independent Economics report, page 3.

13 See ATO company tax data at www.data.gov.au/...

14 See Australian Institute paper at www.tai.org.au/...

15 See for example www.treasury.gov/...

16 According to ATO records franking credit claims are around 30% of company tax collected. See Independent Economics report, page 3.

17 Refer Table 2.1, page 38 of the EM.