

**Business
Coalition for
Tax
Reform**

Level 11, 455 Bourke Street
Melbourne VIC 3000

23 September 2016

Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016

The Business Coalition for Tax Reform (BCTR) strongly supports the passage of this bill in its entirety.

The BCTR is a forum that brings together the views of the business community on various tax reform issues. Our member organisations cover both small and large Australian businesses. A list of BCTR members is provided as Attachment A.

Our members share the common objectives of creating and implementing a better tax system that enhances both international and domestic business competitiveness and fairness, and which assists in creating a business climate that is conducive to investment, growth, job creation and private saving. We appreciate this opportunity to make a submission to the committee on the above bill.

Australia can't afford not to cut rates for all companies over time

The bill proposes a ten-year staged reduction in Australia's company tax rate, which has remained at 30 per cent since the implementation of the Review of Business Taxation reform measures in 2002. In terms of our international competitiveness, those earlier reforms placed Australia's business tax burden at somewhere around the middle of the OECD pack at that time.

The world has not stood still since then, however, and many competitor countries have been reducing their own rates, so that we now sit well above the OECD average (for example, the UK is heading for a 17 per cent rate in the next few years). In an environment where global investment is mobile and highly sensitive to balancing risk and reward, and Australia's recent mining construction boom has not yet been replaced by other major sources of investment, we cannot afford to ignore the ongoing deterioration of our global competitive position. Reducing Australia's corporate rate to 25 per cent for all businesses (in stages over ten years) is an appropriate and timely response to what has been happening around us.

The notion of amending the bill so that tax cuts are denied to larger businesses, even in ten years' time, raises the alarming prospect of Australia's international competitiveness being

even further eroded, with serious consequences for future investment, jobs and wages. As a smaller capital-importing country, we cannot afford not to set out on this modest path to maintaining our competitiveness and our ability to attract much-needed capital investment.

The benefits

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

The costs

The cost of the cuts have been the subject of much debate. While those costs are modest and affordable over the forward estimates, the BCTR acknowledges they will rise as the turn-over threshold is increased over time. Precisely how the net costs are funded over time will be a matter for the government at the time when the relevant budgets are presented. We note, however, that Independent Economics has suggested that in the long-term, some 55 per cent of the revenue foregone is expected to be clawed back through a growth dividend from higher revenues generated across the Federation.

The costs we are more concerned about are the opportunity costs arising from investments that have not proceeded, but which might well have gone ahead but for our relatively high corporate rate causing potential new projects to fail to meet the required hurdle rate. Because those lost investment opportunities remain mostly invisible, it is impossible to measure the negative impact of those forgone opportunities.

Debunking some myths

We would like to address what we regard as some of the flawed arguments we have seen advanced against the proposals contained in this bill.

Australia's dividend imputation system means that our corporate rate is not too high

There is an argument that because Australian shareholders are able to offset company tax already paid against their own tax liabilities when they receive a dividend, the effective rate of company tax on the ultimate owners of the business is a lot less than 30 per cent. Reducing the corporate rate in fact means that Australian shareholders will be entitled to a reduced franking credit and will therefore pay more tax on the dividends they receive.

This argument is questionable for a number of reasons. Firstly, the effect of dividend imputation is that the underlying income of the company is taxed at the shareholder's marginal tax rate. In some case (especially for super funds and many retirees) this will be lower than 30 per cent. However, in many other cases the marginal rate can be as high as 49 per cent.

Secondly, while an analysis of the tax rate facing shareholders is interesting (if ambivalent – some are higher; others are lower), it is far from clear that many Australian domiciled companies make their capital investment decisions on the basis

of the after-tax return for their shareholders. For listed companies, by far the most critical driver for them and their managers is reported earnings, and those earnings are worked out from the perspective of the company on an after-tax basis.

Thirdly, the focus on Australian shareholders of listed Australian companies, while important, assumes we are a closed economy and totally ignores the position of foreign investors. Those investors and their shareholders do not benefit from imputation and their focus will always be on the after-tax outcomes for their Australian investments. For a capital-importing country such as Australia, the factors impacting on the investment decisions made by foreign investors have always mattered.

Any company tax cuts would flow mainly to foreigners

This argument is perhaps another way of stating the previous point. Why should the government sacrifice a lot of revenue in order to give it mainly to foreigners, and why give those foreigners a windfall gain on existing projects in which they invested at the current 30 per cent rate?

The whole point of the proposed company tax cuts is to boost economic growth by encouraging companies to invest more capital in the Australian economy. Business would certainly want foreign investors (as well as domestic investors) to recognise that the after-tax return on both their existing and future projects is going to be enhanced as a result of the proposed measures. This will result in them boosting their investment levels above what they would have been without the rate cut, the benefits of which accrue mainly to wage earners.

Any so-called windfall gains in relation to existing projects are significantly curtailed by the proposed ten-year delay before very large companies become eligible for the 25 per cent rate.

Tax doesn't matter very much

Some say that foreign investors base their investment decisions on a range of factors other than tax, including political stability, our system of laws and regulatory framework, infrastructure, workforce skills and others besides. So instead of joining in the zero-sum game of tax cutting, Australia should be doing more through international forums to strengthen global rules around harmful tax practices.

We consider that while Australia enjoys certain advantages in its overall investment profile, those advantages are hardly unique and they should never make us complacent. At the end of the day any prospective investor will still need to factor in our relatively high corporate rate when weighing up prospective investment decisions. Business tax rates do matter.

The foreign treasury transfer effect

It has been suggested by some that any incentive for foreign-owned companies to increase their Australian investments in response to a cut in our corporate rate will be substantially negated where those companies operate under a foreign tax credit system. It is claimed that any tax reduction in Australia would be offset by increased taxes at home, so that the proposed cuts will simply transfer revenue from the

Australian Treasury to places like the US without creating any incentive to increase the level of investment here.

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

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

Large companies don't pay their fair share of tax as it is

Recent reports and parliamentary enquiries are seen by some to have uncovered widespread tax avoidance by large multi-national companies. If this were broadly correct, it would follow that if these companies could be made to pay their fair share of tax our budget problems would be much less pressing.

Whether looked at in aggregate or in relation to particular companies, the data tells us that most large companies have consistently paid high levels of income tax in Australia and there is a strong culture of voluntary compliance, supported by a well-resourced and active regulator. In spite of flat corporate earnings, corporate tax payments in Australia have been steadily growing since the GFC and are forecast to reach \$69 billion in 2016-17. As a percentage of GDP, company tax receipts in Australia remain higher than in almost any other country.

Australia's tax integrity rules are among the most stringent in the world and have been further strengthened by successive governments in recent years. The ATO has also been given additional resources in the 2016-17 budget by way of the establishment of a Tax Avoidance Taskforce. The majority of large companies are doing the right thing, according to the Commissioner of Taxation. Those that may be engaging in sharp practices will continue to be subject to targeted ATO compliance activities.

Our robust legal and institutional settings in fact represent a strong foundation for the proposed corporate tax cuts.

The tax cut should be confined to smaller companies

Some contend that large companies avoid paying their fair share of tax and that smaller companies are more likely to be responsive to a tax cut. Therefore, the argument goes, the proposed cuts should not be extended to very large companies.

There is in fact no evidence one way or the other as to whether smaller companies are more or less compliant with our tax laws than large companies, nor indeed whether they would be more or less responsive to a rate cut.

The fact is that commercial activity is an integrated process comprising both larger and smaller businesses which have extensive dealings with each other. Encouraging larger companies as well as smaller ones to increase their investment levels and create

more jobs will benefit all companies – smaller and larger alike. Those benefits flow through to all Australians.

Conclusion

The bill represents the first attempt by any government for many years to begin to address the barriers to increased investment created by Australia's increasingly uncompetitive corporate tax rate. Unless this issue is addressed by passing the bill in its entirety, we face a high tax/high cost future with reduced levels of investment, a slower economy, fewer jobs and reduced real wages.

Thank you again for this opportunity to provide insights into the very important issues raised by this bill. For further comments or clarification, please feel free to contact the undersigned.

Yours Sincerely,

(Frank Drenth)
Chair, BCTR

Attachment A

Business Coalition for Tax Reform Members

Australian Bankers Association Inc

Australian Chamber of Commerce

Australian Financial Markets Association

Australian Institute of Company Directors

Business Council of Australia

Corporate Tax Association of Australia Inc

CPA Australia

Financial Services Council Ltd

Insurance Council of Australia

Minerals Council of Australia

Property Council of Australia

Real Estate Institute of Australia

Urban Development Institute of Australia (National)