Chapter 2

The corporate tax cuts are dead; long live tax reform

2.1 The committee welcomes the government's decision not to proceed with the second stage of the enterprise tax plan.

2.2 Evidence provided to this inquiry, extensive debate in the Senate chamber, and wider discourse in the public arena, did not clearly articulate how a reduction in the corporate tax rate would directly lead to higher wages and better economic outcomes for the majority of the Australian population. Indeed, the case for corporate tax cuts made by the government and its advocates, including the Business Council of Australia (BCA) and its members, was tenuous at best and did not convince the Senate crossbench or the general public that it should be supported.

2.3 Professor Peter Swan considered the link between corporate tax cuts and wage increases was not clearly established:

> The plan to reduce corporate taxes and therefore indirectly through capital deepening investment leading to higher demand for labour and higher wages is an extremely roundabout process and in my view is unlikely to happen to any great extent in this instance.[1]

2.4 Dr Richard Denniss from The Australia Institute supported this conclusion:

> If the purpose of paying higher wages is to spend shareholders' money as carefully as you can to attract the staff you need to make as much profit as you can, then why, when you could get a windfall gain in the form of lower taxes, would you take your shareholders' money and sprinkle it over your workforce after you've spent ten years of not doing that?[2]

2.5 The BCA could not provide the committee with any demonstrable evidence that corporate tax cuts would boost gross national income and wages for non-executive employees. Mr Warwick Smith from Per Capita Australia noted that the BCA did not use academics to support the case for tax cuts:

> They don't cite academics because the academics are saying, 'Well, you know, we can cut taxes, and, yes, there's an incentive for greater investment, but there's currently a disconnect between labour productivity and wage outcomes. Historically, we have had a pretty strong relationship between labour productivity and wages, but in recent years that relationship has broken, so we might get investment and we might increase labour productivity, but, on recent data, it's likely that that will result simply in greater profits rather than a flow-through, necessarily, to wages.'[3]

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1 Professor Peter Swan, *Committee Hansard*, 24 April 2018, p. 5.

2 Dr Richard Denniss, Chief Economist, The Australia Institute, *Committee Hansard*, 24 April 2018, p. 30.

3 Mr Warwick Smith, Senior Economist, Per Capita Australia, *Committee Hansard*, 26 April 2018, p. 25.

2.6 Further, many of the corporations that signed the BCA Commitment and attended the public hearings could not readily give examples of actual investments that would potentially go ahead with the reduced corporate tax rate that otherwise would not have met the investment criteria required to proceed.

2.7 Arguments were made by some stakeholders that Australia needs to reduce the corporate tax rate to remain an internationally competitive destination for capital investment. However, while corporate tax rates are an important factor, the committee heard from numerous stakeholders, including companies which signed the BCA Commitment, that a variety of other factors—including a developed economy, stable government and educated workforce—were also considered when large multinationals make investment decisions between options in different countries. The Tax Justice Network Australia cited the Organisation for Economic Co-operation and Development's (OECD's) perspective on foreign direct investment (FDI):

> According to the OECD there is broad agreement that a low host country tax level cannot compensate for a generally weak or unattractive FDI environment…Several large OECD countries with relatively high tax rates are very successful in attracting FDI, suggesting that market size, non-tax factors and taxable location-specific profits are particularly important in attracting FDI.[4]

2.8 Several stakeholders examined the effect of and motivations for reducing the corporate tax rate in the United States. Ms Emma Dawson from Per Capita Australia commented on the effect of the tax cuts in the United States:

> The US is often cited as an example of why we should cut corporate taxes, but there's very little evidence coming out of the US that those tax cuts have flowed through to wage growth at all.[5]

2.9 Similarly, Mr David Richardson from The Australia Institute also pointed to evidence from the United States that indicated increases in company profitability primarily went towards stock buybacks and dividend increases:

> This inquiry is being held in the shadow of the US company tax cuts, and now we're starting to see some results from those. The promises of investment, employment and wage increases haven't turned out the way they were promised; instead, we've seen massive expenditure on share buybacks and increases in dividends…[6]

2.10 Mr Warwick Smith from Per Capita Australia also highlighted some unique company behaviour underlying the push for a corporate tax cut in the United States:

> …an important factor in US corporate tax cuts is the fact that there are many US companies who have huge piles of cash sitting in offshore tax

4 Tax Justice Network Australia, *Submission 13*, p. 7.

5 Ms Emma Dawson, Executive Director, Per Capita Australia, *Committee Hansard*, 26 April 2018, p. 26.

6 Mr David Richardson, Senior Research Fellow, The Australia Institute, *Committee Hansard*, 24 April 2018, p. 21.

> havens. Part of the motive for reducing the tax [rate] there was to repatriate some of that cash. It's just not the case here [in Australia]; we don't have the same situation.[7]

2.11 Importantly, any reduction in the corporate tax rate would directly reduce government revenue and put into jeopardy any projected budget surplus over the forward estimates. Successive budgets over the last five years have consistently projected a budget surplus without ever achieving such an outcome. Consequently, broad based corporate tax cuts which largely benefit foreign investors do not represent a fiscally prudent approach to economic management when net government debt has yet to peak. Ms Danielle Wood from the Grattan Institute contended that:

> …reducing tax revenue during a period when the budget is still in deficit…will create further pressures. Sustained budget deficits…[limit] our capacity for future borrowings and for governments to respond to adverse economic shocks.[8]

2.12 Greater productivity benefits, and associated wage increases, are more likely to come from targeted measures to boost investment—such as research and development incentives and capital deepening—rather than broad corporate tax cuts. The Grattan Institute noted that targeted approaches could also have a smaller impact on the budget:

> These schemes are cheaper than a company tax cut because they only subsidise *new* investment, they do not provide a windfall gain on historical investments.[9]

2.13 The committee notes that following the stalling of the government's 2015 *Re: think* tax reform consultation process, subsequent tax reform proposals—involving corporate income tax, personal income tax and superannuation for example—have not been adequately explained or presented by the government in the context of a broader tax reform agenda. Ms Wood from the Grattan Institute noted that the final report for the review into *Australia's Future Tax System* (the Henry Review):

> …had a whole lot of broader recommendations about how you change the tax mix in order to grow the size of the economy. We [The Grattan Institute] certainly would be a lot more comfortable in a world where you are talking about that kind of tax reform package as opposed to pulling a single lever.[10]

2.14 Instead of considering the corporate tax cuts in isolation, what Australia needs is a comprehensive and integrated plan to reform the tax and transfer system in way

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7 Mr Warwick Smith, Senior Economist, Per Capita Australia, *Committee Hansard*, 26 April 2018, p. 31.

8 Ms Danielle Wood, Budget Policy and Institutional Reform Program Director, Grattan Institute, *Committee Hansard*, 26 April 2018, p. 13.

9 Grattan Institute, *Submission 15*, p. 11.

10 Ms Danielle Wood, Budget Policy and Institutional Reform Program Director, Grattan Institute, *Committee Hansard*, 26 April 2018, p. 17.

that will grow the economy while also addressing rising inequality. Indeed, the International Monetary Fund (IMF) is cited by The Australia Institute as cautioning against the narrow pursuit of economic growth:

> …it would be a mistake to focus on growth and let inequality take care of itself, not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable.[11]

2.15 Similarly, Dr Shumi Akhtar from the University of Sydney Business School argued that:

> A thorough investigation of how the tax system interacts with and affects its micro and macroeconomic systems (e.g. through education, housing affordability, healthcare, infrastructure improvement, research innovation and education, employment, climate, immigration, etc), financial system (e.g. foreign trade and foreign direct investment) and inequality (gender pay gap, ethnicity/cultural pay gap, homelessness, tax policy on immigrants who left their capital in their home country, tax policy on retirees/pensioners etc) is sorely needed before making a conclusion as all of these factors contribute to economic growth…[12]

2.16 In conclusion, the Commitment to the Senate by the BCA was non-binding and did not provide any degree of confidence that the benefits of corporate tax cuts would be shared with non-executive employees through higher wages. The committee is surprised that it has taken the government so long to realise that the general public are not in favour of giving significant tax cuts to multinationals and foreign investors. Even the Governor of the Reserve Bank of Australia considered that it would be a mistake to lower corporate tax rates if it comes at the expense of higher budget deficits.[13]

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11 The Australia Institute, *Submission 11*, p. 31.

12 Dr Shumi Akhtar, University of Sydney Business School, *Submission 4*, p. 2.

13 Dr Phillip Lowe, Governor, Reserve Bank of Australia, House of Representatives Standing Committee on Economics, Review of the Reserve Bank of Australia Annual Report 2017, *Committee Hansard*, 16 February 2018, p. 14.