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SIX MYTHS ABOUT THE BUSINESS TAX CUT

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"If you reduce the business tax you get more investment and better wages."[1] - Prime Minister Turnbull, 1 February 2018

The government proposed cutting Australia's business tax rate from 30% to 25% by 2026-27. In 2017, the Senate passed a portion of the tax cut by reducing the rate to 27.5% for businesses with less than $25 million in annual turnover. Six myths about the business tax cut are discussed below.

Myth 1: Australia's Business Tax Rate is Not High

Australia's top marginal business tax rate of 30% is one of the highest in the developed world. It is well above the OECD average of 24% and other comparable nations such as the U.K. (17% by 2020), the U.S. (21%), and Singapore (17%).

Chart 1: Comparison of Corporate Tax Rate

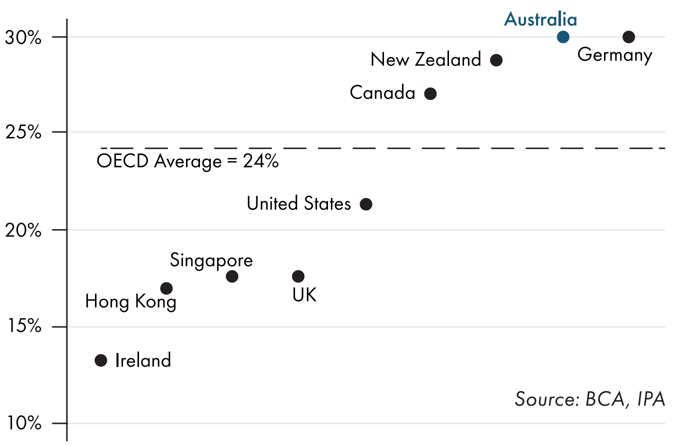
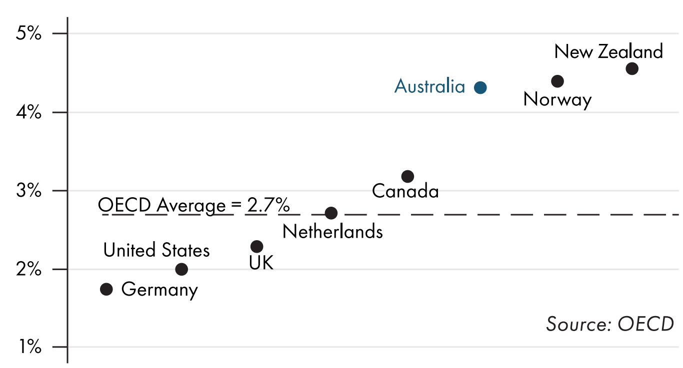


Chart 2: Corporate Tax Take as Percentage of GDP



The Commonwealth government also has an abnormally high reliance on the business tax. In 2015, the Australian government take of the business tax was 4.3% of GDP. This is substantially higher than the OECD average of 2.7%.[2]

Myth 2: Dividend Imputation Removes the Benefits of a Tax Cut

Some argue that Australia's dividend imputation system reduces, or nullifies, the benefits of a company tax cut.[3]

In most cases Australian shareholders are provided with a franking credit worth 30 cents in the dollar for dividends that have already been taxed at the 30% company tax rate. This means the tax rate paid by the shareholder on dividend income is the difference between their personal income tax rate and the company tax rate.

Dividend imputation is important because it removes the double taxation of company income. Removing or limiting dividend imputation to 'pay for' the company tax cut would be bad policy as it would counteract the positive effects of the tax cut.

Critics correctly argue that the franking credit will be reduced following the business tax cut. This means shareholders will face a higher tax rate on the franked dividend, although this will be partly offset by a higher dividend payment.

However, this obfuscates the most important point: a lower company tax rate increases after-tax business profits, which flows through the economy in a number of ways.

Myth 3: Multinational Tax Avoidance is Widespread

Some claim multinational firms avoid tax and shift profits to overseas destinations which reduces their effective tax rate.[4] The effect of this would be to erode the business tax base, which would be revealed through a lower ratio of business tax to GDP, and a lower ratio of business tax to revenue.

However, the best available evidence suggests the extent of profit shifting is low and the business tax base in Australia has grown overtime.

- Recent empirical work suggests that multinational firms operating in high-tax jurisdictions shift only between 2% and 4% of their profits to lower tax jurisdictions.[5]
- Professor Sinclair Davidson and Dr Chris Berg found that "the company tax base has broadened over time, especially since the early 1980s."[6]

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- The Australian Tax Office said in 2015 that "...we know that the majority of large businesses operate within the law and pay the right amount of tax."[7]

Further, one of the main causes of profit shifting is the relative tax rate difference between Australia and other, lower tax jurisdictions. Reducing the business tax rate in Australia will reduce the extent of profit shifting. In that sense, reducing the business tax rate is a true tax integrity measure.

Myth 4: Company Tax Cuts Only Benefit Big Businesses

Companies do not exist independent of the employees, owners, shareholders, customers, and suppliers they are comprised of. It is these individuals who pay the business tax – through lower wages, lower investment returns, and higher prices – not the businesses per se. And it is these individuals who benefit from the company tax cut.

Lower company taxes will increase after-tax profits. This will make Australia a more attractive country for businesses to invest in. This means more businesses will choose to invest more capital in Australia, which will increase economic output and, consequently, the demand for labour and wages growth. The Treasury estimated that reducing the business tax rate to 25% will increase GDP by 1%, or $17 billion each year.

The main benefit of a company tax cut will flow to workers.

- Economist John Freebairn found one-half of the benefit of a corporate tax reduction goes to higher wages.[8]
- Treasury estimated that two-thirds of the benefit of a company tax cut flows through to households, primarily through rises in real wages.[9]
- Even Former Treasury Secretary Ken Henry stated "if the company income tax were to be cut, the principal beneficiaries will be workers..."[10]

Myth 5: The Benefits of a Tax Cut will Take Years to Materialise

The benefits of a tax cut will be immediate. To date more than 160 firms in the United States have provided staff bonuses, pay rises, and other benefits as a direct result of the Trump administration cutting the United States' corporate tax rate to 21% from 35%. These include:

- AT&T, the world's largest telecommunications company, paid a $1,000 bonus to 200,000 workers.[11]
- Boeing invested an additional $300 million on employee-related and charitable activities.[12]
- Walmart, the world's largest company, announced it would also spend $300 million on wage increases, including bonuses of up to $1,000 per employee.[13]

Similar results would occur in Australia:

- Elmer Funke Kupper, CEO of the ASX, said cutting the business tax in Australia to 25% "would allow us to increase staff by 10 to 15 per cent."[14]
- Andrew Mackenzie, CEO of BHP Billiton, said tax cuts could lead to projects being approved within months.[15]
- Alison Watkins, Group Managing Director at Coca-Cola Amatil said "there's no doubt a lower company tax rate makes Australia a more attractive place to invest capital and create jobs.[16]

Myth 6: The Tax Cut is Unaffordable

Some argue the proposed tax cut is unaffordable.[17] However, this assumes that a tax cut is equivalent to additional expenditure. This is false. Australian workers, businesses, and shareholders own their pre-tax income, not the government. A tax cut means the government is taking fewer resources from Australians, not spending more revenue.

Nonetheless, revenue will decrease if the company tax rate is cut. The Treasury estimated 50% of the direct revenue loss is recouped through secondary effects such as higher wages.[18] To achieve revenue neutrality, the remaining 50% should come from reducing government spending. The Treasury found reducing spending and lowering corporate tax provided a much larger boost to national income than offsetting company revenue losses with higher personal income taxes.

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