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OPINION
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Company tax cut will build our society, not tear it up

If companies invest elsewhere then it is workers who will pay. **Rob Homer**

by **Chris Murphy**

Craig Emerson's piece 'Company tax cuts will tear at Australia's social fabric' in *The Australian Financial Review* on Tuesday takes off well before nosediving into a conspiracy theory.

In taking off, Emerson points out that we need to analyse "who ends up paying" company tax. Companies are only legal entities, and they can pay company tax only by paying their workers less, their shareholders less or charging their customers more. Many of us pay company tax in all three ways, as we work for a wage, are shareholders through our superannuation and buy things every day.

Those who instead pretend that company tax is ultimately paid by companies, not people, are on an ideological crusade. If that were really true, we would tax companies at 100 per cent. The ideologues should move on and focus on the interests of ordinary Australians who, in the end, pay company tax.

Emerson also acknowledges the case that reducing the tax rate for larger companies from 30 to 25 per cent would be good for investment, productivity and wages. He also agrees that, in setting our company tax policy, we should be watching "the global company tax rate situation". So we should. Since the Henry Tax Review commissioned by the Rudd Government first recommended in 2010 that we should cut our company tax rate to 25 per cent, we have seen major company tax rate cuts in the three countries we rely on most for foreign investment – the USA, UK and Japan. Bringing our company tax rate down in line with the countries we rely on to fund our business investment seems a rather obvious thing to do.

Then comes the nosedive. Emerson mounts the conspiracy theory that the proposal to reduce the company tax rate to 25 per cent is part of a wider plot to tear at the social fabric, which I will return to later. In doing so, he follows a well-worn path for critics of the proposal. They know why we should do it. But as each reason they dream up for not doing it is discredited, they just dream up another one, in a triumph of ideology over reason.

I'll start with the reasons we should move to a company tax rate of 25 per cent and then run through the list of dreamt up objections.

The reasons for making this company tax cut, and many other worthwhile tax reforms, were set out in the Henry Tax Review. When Australia maintains a company tax rate higher than elsewhere, foreign investors here do not take the hit because they don't have to. There are plenty of other countries where they can invest.

Instead, investment weakens and wages are squeezed or prices rise until investment in Australia stacks up again. That is, in the end, we pay, not the foreign investors. And the extra company tax revenue we think we might bring in from maintaining a higher company tax rate soon becomes eroded. The tax avoidance industry finds ways of shifting accounting profits to lower taxed countries.

The Australian Taxation Office does its best to stop this. However, with an Australian company tax rate of 30 per cent outstripping rates in other countries they are tasked with doing the near impossible.

So maintaining an uncompetitively high company tax rate means that we consumers take a large hit for a disappointing gain in government revenue. The only winner is a thriving tax avoidance industry.

Reducing the company tax rate to 25 per cent can avoid this scenario. The effects can be weighed up using economic modelling that is based on research around the world on the impacts of company tax. I've undertaken such modelling for the Australian Government's Henry Tax Review, its Business Tax Working Group (both under ALP governments) and the most recent Tax Review (under the Coalition government). The Tax Review cast widely for modelling evidence; besides my own modelling, the Treasury undertook modelling in-house as well as commissioning modelling from KPMG. Since then, similar modelling results have also been obtained by Tran and Wende. So we have four modelling studies, all providing support for the proposed company tax cut.

In deciding whether to cut company tax rather than some other tax, the key question is size of the gross benefit to consumers relative to the revenue cost to government. For consumers, cutting the company tax rate from 30 per cent to 25 per cent has an estimated benefit that is 2.04 times the cost to government. By comparison, cutting personal income tax has a consumer benefit to cost ratio that is a much lower 1.25 to 1.42 times, depending on the nature of the cut. For cutting the rate of GST, the benefit to cost ratio is even lower at only 1.24 times.

Emerson worries that going down the path of cutting the company tax rate, rather than some other tax, may be inequitable, but modelling shows this concern is unfounded. Whether your main source of income is wages, assets or a benefit linked to wages such as the age pension, you benefit more from a company tax cut than a regular cut to personal income tax or the GST that has the same cost to the government budget. The reasons are that company tax is a bigger drag on the economy because it discourages investment, and its revenue raising is undermined by profit shifting.

The changing justifications offered by critics for not cutting our company tax rate to 25 per cent are many.

With much fanfare, the Australia Institute pointed out in 2016 that some US-based multi-nationals were partly insulated from Australian company tax because they could claim a tax credit in the US for their tax paid in Australia. However, the Australia Institute did not acknowledge that this insulation effect had already been taken into account in the modelling. Further, this effect has now disappeared because the US has just moved to a territorial system of taxation, like all other major industrialised countries. When will the Australia Institute acknowledge that this argument has lapsed?

Emerson brings up the Australia Institute argument that reducing the Australian company tax rate from 30 to 25 per cent won't help reduce profit shifting. They say that would require Australia going down to a tax haven rate of 5 per cent. This is based on the misconception that all profit shifting involves tax havens. In fact, profit shifting occurs from Australia with its high company tax rate of 30 per cent to countries like Singapore with a tax rate of 17 per cent. The very extensive international research on profit shifting, including involving detailed analysis of the behaviour of individual multinationals, shows that every reduction in a country's company tax rate helps reduce profit shifting. When will the Australia Institute admit this?

Emerson also takes up the misleading argument that the benefits from the proposed company tax cut are not large in relation to the economy. Of course what matters is the benefit relative to the cost to the government budget, compared to other tax reduction options available to government. As detailed above, the company tax cut provides consumers with much bigger benefit per dollar of budget cost than cutting either personal income tax or GST. Why would anyone want to deny consumers the type of tax cut that provides them with the most benefit per dollar of budget cost?

In a recent strange intervention, it was argued foreign investors can escape company tax by trading in dividends, so company tax does not discourage investment. Specifically, it was theorised that foreign investors could receive a refund of Australian company tax by selling their dividend rights to Australian investors. Allegedly the Australian investors would pay them for the franking credits to the dividends, achieving a de facto refund of company tax. However, even a cursory look at the cum-dividend market shows that dividend rights trade at prices that do not make any significant allowance for the value of franking credits. This strange theory is immediately discredited by market data but the ideologues continue to promote it.

Emerson also echoes the proposition that while a company tax cut may encourage new foreign investment in Australia, it also provides foreign investors with a windfall gain on their existing investments here. Supposedly this means that a company tax cut should be reconsidered. However, this question was considered and answered in the economics literature 30 years ago. The solution is to go ahead with the cut, but phase it in. This limits the benefits for existing investments, while providing a positive signal for new investment.

Now we get to Emerson's real nosedive. He claims my research is part of a conspiracy to cut the company tax rate to zero, and tries to mount a scare campaign on that basis. My modelling does not support that and the paper Emerson refers to makes this very clear. While company tax damages investment and is open to avoidance, there remains a place for it for as long as some companies are able to make excess profits because of advantages such as market power. That justifies a company tax rate of 20 per cent or, at the lowest, 15 per cent. Other countries have reached similar conclusions, and hence the UK has cut its rate to 19 per cent and the US to 21 per cent. No major developed country wants to cut its rate to zero, nor should it.

So if the Australian Parliament does cut the company tax rate to 25 per cent, more is likely to be needed down the track. As I argue in my paper, there is a case for funding further action from within the business tax envelope. This might involve requiring companies with excess profits to pay more or it could involve re-examining Australia's overly-generous imputation system for taxing dividends. But that is an issue for the next stage of business tax reform.

If our leaders have our best interests at heart, in the next stage of business tax reform they will work to arrive at a bipartisan solution so businesses can invest with confidence. Otherwise businesses will have to hold back, because our politicians want to make business tax policy their political plaything. That will mean less investment, lower productivity and lower wages, making we consumers worse off.

Chris Murphy is a visiting fellow at the ANU.

AFR Contributor

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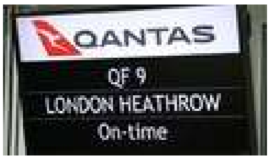

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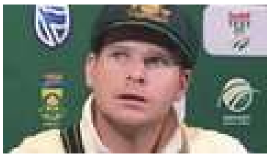

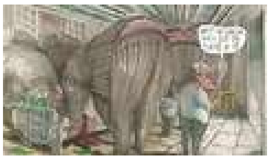

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