Creating a more dynamic and resilient economy inquiry

Questionnaire response 19

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1. Support business investment through corporate tax reform

1. What features of the Australian business environment have encouraged or restrained investment over the past 10 years?

The PC has correctly identified tax settings as a reason for decline in business investment.
There are many other potential causes of the investment slowdown:
• Public crowding out. The growth in the size of Government, including through off-budget spending, is likely crowding out private spending.
o Government intervention is also transferring resources from more capital intensive sectors (the market sectors) to less capital intensive sectors (the ‘care economy’ sectors). This also may be having adverse effects on investment.
• IR policies – particularly policies that facilitate holdup of capital intensive businesses. This may for example include IR rules that facilitate the extension of enterprise agreements across an industry/sector, major restrictions on casuals and labour hire, rules that facilitate industrial disputes, and artificial caps on lengths of agreement. The need for these rules is highly questionable where employees are already on very high wages.
• Planning approval processes subject to extensive delays and reviews. The substantial delays in approvals for mining, extraction, electricity transmission and renewable projects are well known.
• Foreign investment rules that have become more costly and process-heavy. The PC itself has done valuable work on this issue.
• Macro shocks such as interest rates, the Covid pandemic and the Ukraine war.
• The boom in mining prices causing a reduction in competitiveness of the rest of the economy (a point noted by Ken Henry in several recent speeches).
However, in general the above issues have had different effects across the decade, while investment as a share of GDP has remained low over the whole decade. This suggests the above factors may not be the most substantial causes of the investment slowdown at a macro level. In other words, the above issues would have had varying impact during the past decade, and not had a lasting impact over the whole decade.
By contrast, tax settings are more likely to have had an impact across all of the past decade, because corporate tax has not had major changes (though there have been many micro changes). This makes it seem more plausible that this is a key driver of low investment levels.
There has been a slowdown in investment in other developed countries, but the slowdown in Australia appears to be more marked. The PC could investigate this comparison in more detail to rule out common factors applying across multiple countries.
There are other possibilities for explaining the investment slowdown. One that has been posited as a reason is increasing monopolisation or oligopolisation of the economy.
Other research, including by the PC, finds the evidence on price markups to be unclear, see: https://www.pc.gov.au/research/supporting/economic-dynamism/economic-dynamism.pdf
This is supported by recent PC and Treasury research showing recent inflationary

episode was not caused by increased business profits/markup. I believe the RBA may have reached a similar conclusion.
Similarly, the PC has found most industries are not concentrated and concentration hasn’t increased over recent years, see: https://www.pc.gov.au/media-speeches/speeches/competition-dynamism
Nevertheless, there may have been some increases in Australian markups, and this may explain some the cut in business investment. While competition policy is best targeted at addressing this issue, it can also be assisted by taxes on rents and monopoly profits which are discussed further below.

2. What elements of the corporate tax system encourage and/or discourage investment and risk-taking?

The supply of global capital to Australia is highly elastic (ie, responsive to returns). Australia is essentially a price taker for capital - if we have a tax on capital that is higher than the global rate, this will lower the after-tax return on capital (relative to the global rate). The supply of capital will decline to Australia until the marginal return to capital increases enough to exactly offset Australia's uncompetitively high tax on capital. Conversely, if Australia reduces our tax rate on capital, the global supply of capital to Australia will increase, driving down the marginal return on capital by an amount equal to the tax cut.
Australia’s corporate tax rate is clearly well above comparable countries. The Tax Foundation stated in December 2024 that the worldwide average statutory corporate income tax rate, measured across 181 jurisdictions, is 23.51 percent. When weighted by GDP, the average statutory rate is 25.67 percent. The OECD average is 23.85%, and the average has consistently decreased since 1980. see:
https://taxfoundation.org/data/all/global/corporate-tax-rates-by-country-2024/
The OECD’s corporate tax database produces similar results, showing Australia’s tax rate is above numerous measures of averages, see:
https://www.oecd.org/en/publications/corporate-tax-statistics-2024_9c27d6e8-en.html
Australia’s current corporate tax settings are keeping the capital stock lower, and the marginal return on capital higher, than in countries with lower tax rates on capital. The lower capital stock will harm labour productivity, because the capital level will be lower per worker. This will harm GDP growth. The close link between labour productivity and wages (demonstrated in PC and RBA work) means wages will also be lower.
This does show one unexpected result of Australia's high taxes on capital – they could be increasing inequality in Australia by causing the Australian marginal return on capital to be higher than in other countries.
A cut in capital taxation will provide windfall gains to existing capital owners which may not be desirable. This can be addressed by phasing in a reduction in capital taxes, so that substantial parts of the existing capital stock are depreciated by the time the full tax reduction is implemented. Note that any windfall to existing shareholders will be partly clawed back through increases in Capital Gains Tax revenue when shares are sold.
Another option is to implement a reduction in capital taxes only for new capital investment – this which would have the added benefit of costing the Budget less but achieving a similar/same economic benefit. This can be achieved through various means. One suggestion is immediate expensing of depreciating assets. However, this does have uneven impacts – in particular it has no impact on assets that don't have tax depreciation. Some intangibles can’t be depreciated, and there is a notable increase in the importance of intangibles in business.
A better solution could be an Allowance for Corporate Equity (ACE) and other similar

proposals - covered in more detail in other works, particularly:
• Peter Birch Sørensen and Shane Matthew Johnson (2009) Taxing Capital Income: Options for Reform in Australia (paper for the Henry Tax review); and
• Kristen Sobeck, Robert Breunig, Alex Evans (2022) Corporate income taxation in Australia: theory, current practice and future policy directions.

Imputation

Australia's imputation system means that our corporate tax system ends up being a tax that largely falls on foreign capital (as it is largely refunded on Australian capital). Arguments that foreign investors gain full value for imputation credits (and hence do not care about Australia's corporate tax rate) are incorrect, for many reasons including:
• This view would mean multi-billions of tax avoidance occurring every year through trading/washing in imputation credits, right under the ATO's nose. There is absolutely no evidence that the ATO is missing tax evasion/avoidance of this scale relating to imputation credits.
• If true, this view would mean companies would not care about the company tax rate, as it would all be fully refunded. It is hard then to see the substantial effort that many, particularly the BCA and MCA, put into advocating for cuts in company taxes.
• This view would mean the net budget cost, after franking refunds, of corporate taxes would be zero, and the corporate tax rate would not matter. In which case, any and all reductions in corporate tax rates would cost the budget nothing in net terms. Given this, we might as well abolish the corporate tax system entirely, removing the substantial administrative and compliance costs of the system.

It is also notable that the Australian Energy Regulator has repeatedly found that franking credits are not fully utilised by foreign investors, and puts a value on them of much less than 100%, see this, in particular section 9: https://www.aer.gov.au/documents/aer-rate-return-annual-update-2024-december-2024

Evidence

Regardless of imputation, there is evidence that Australia's corporate tax settings, both rate and base, have an impact, see in particular example:
• AlphaBeta (2018). 'Do company tax cuts boost jobs, wages and investment? Evidence from the 2015 Australian tax cuts for businesses'. Report for Xerox Small Business Insights; and
• Rodgers, D., and Hambur, J. (2018) "The GFC Investment Tax Break" RBA Research Discussion Paper 2018-07. Reserve Bank of Australia, June.
o The finding in this report appears to be confirmed by Nu Nu Win, Jonathan Hambur and Robert Breunig (2025) Are Investment Tax Breaks Effective? Australian Evidence, RBA Research Discussion Paper – RDP 2025-01, which however finds other tax breaks are less effective, perhaps reflecting the differences between tax rates and investment incentives.

There is a vast international literature on the impact of company tax, which I would recommend the PC review and synthesise.

Rents

It has been argued that corporate tax reductions are not needed because a substantial part of the tax burden falls on rents or monopoly/oligopoly profits. This is misleading at best. First, it is plausible that at least some oligopolies and monopolies choose prices as a percentage markup over costs – in which case the costs of corporate taxes are higher rather than lower, as they exacerbate the cost markup problem.

Second, corporate taxes are a very poor substitute for a tax on rents. They tax all profits, whether normal or supra-normal, at the same rate. Marginal investments face the same tax rate as highly profitable investments. It is far better to impose a tax on rents from all

sources and lower or remove the tax on marginal investments. This would be achieved by an Allowance for Corporate Equity and similar alternatives, see citations above. Third, it is not clear that a substantial part of the burden of corporate taxes falls on rents rather than normal profits. It is also not clear that share of rents in total profits has been growing (as noted earlier, it is not clear that average markups, an indicator of oligopoly rents, have increased in recent years).
It is likely that natural resource rents have increased during the mining boom, but at the same time royalties on resource extraction have increased, in some cases quite steeply. Regardless, it would still be better to replace both mining royalties and corporate taxes with appropriately designed rent taxes.

3. Which parts of the corporate tax system do you find the hardest, or most time or cost-intensive to comply with? How could the compliance burden of the business/company tax system be reduced?

The participant did not respond to this question.

2. Reduce the impact of regulation on business dynamism

1. What areas of regulation do you see as enhancing business dynamism and resilience? What are the reasons for your answer?

The participant did not respond to this question.

2. How has your regulatory burden changed over time?

The participant did not respond to this question.

3. What regulations do you find time-consuming, overly complex or otherwise constraining business dynamism and resilience? What are the reasons for your answer?

The participant did not respond to this question.

4. Can you share any specific examples of where you think a regulator has done a good or bad job of understanding and reducing regulatory burden on businesses and why?

Many regulators, particularly ASIC and ATO, are arguably in breach of the Regulatory Impact Analysis requirements by not conducting and publishing an RIA on any decisions with more than minor impact on business.

The specific statement in the Australian Government Guide to Policy Impact Analysis, March 2023, is that "a proposal that must be accompanied by Impact Analysis is: Any policy proposal or action of government, with an expectation of compliance, that would result in a more than minor change in behaviour or impact for people, businesses or community organisations" (p8).

The same publication also makes it clear that this requirement applies to statutory authorities (p50).

The report furthermore states "If a decision is not going to Cabinet, Impact Analysis is still required where the policy proposal is likely to have a more than minor impact on people, businesses or community organisations. This includes new regulations, amendments to existing regulations and, in some cases, sunsetted regulations being remade. It also includes decisions of regulators that already have existing legislative or regulatory authority." (p50).