Creating a more dynamic and resilient economy inquiry

Questionnaire response 36

Name: Australian Industry Group

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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 burden of company tax has gradually but materially increased over the last ten years. In 2023-24, company tax generated $144.2 billion of revenue, equivalent to 5.4% of GDP. In 2013-14 the figure was 4.2%. Had that rate of effective burden been maintained over the last decade, company tax revenue today would be $37.3 billion lower.

Over the last decade, the tax burden in the Australian economy has risen from 27.4% to 30.0% of GDP. However, only two components of the tax system – company tax and personal income tax – have been responsible for this rise. All other forms of taxation have seen their burden remain constant or fallen.

This has led to a tax mix which is increasingly dependent on taxing the productive activities of businesses – which generate profits (company tax) and employment (income tax). By corollary, the tax mix has become less reliant on broad-based taxes such as GST and those on rent-generating assets (such as property and land). This therefore acts as a progressive disincentive to investment in productive business activities relative to other forms of capital allocation.

An increasing reliance on company tax also acts as a barrier to investment via its interaction with the dividend imputation system. A known feature of dividend imputation is that it creates a bias towards dividend payment over reinvestment (due to the risk of potentially 'trapped' franking credits). To the extent that company tax becomes a larger component of Australia's tax mix, so too does the impact of the imputation bias against reinvestment and its dampening effect on investment rates.

In international comparison, Australia's rate of company tax is uncompetitively high. Australia's statutory corporate income tax rate of 30% is the sixth highest in the OECD and compares unfavourably to the group average of 24.2% in 2023. Australia's effective average rate of 28.5% is the second highest, and greatly above the OECD average of 21.9%.

Australia's relative tax competitiveness has also declined over time. In 2017, the effective average corporate income tax rate in the OECD was 23.6%. Changes to reduce the effective burden of corporate income taxes in many OECD governments had reduced the figure to 21.9% by 2023. Australia has made no matching reforms to reduce either statutory of effective average corporate income tax rates, resulting in our tax competitiveness declining relative to OECD peers.

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

The corporate tax system extends beyond company taxes. Businesses are subject to a wide range of taxes, levies and charges from the Commonwealth and state government which influence the level and form of investment decisions. In 2023-24, the taxes and charges directly collected from business consisted of the following:

• Company tax: $144.2 billion of revenue

- Payroll and employment taxes: $40.7 billion
- Other Commonwealth taxes and levies: $46.8 billion
- Other state taxes and levies: $10.8 billion
- Total: $242.5 billion

Businesses also carry a material proportion of the taxes on property ($45.2b of revenue in 2023-24), insurance ($9.4b) and financial transactions ($32.1b). These taxes are also levied on individuals, and it is not possible to attribute shares to businesses based on currently available data. However, their collective value suggests the tax burden on business is materially higher than the $242.5 billion directly collected.

Importantly, company tax accounts for only 59.5% of the tax revenue directly collected from businesses. None of the other taxes and levies are subject to dividend imputation, suggesting a significant degree of double taxation of business activity. When read together, they also indicate a much higher degree of total tax burden on business (9.1% of GDP) than the rate for company tax alone (5.4% of GDP) implies.

It is therefore critical that any consideration of the impact of the corporate tax system on investment evaluates the full suite of taxes to which businesses are subject.

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 sheer number of taxes to which businesses are subjected is itself a source of regulatory burden. Many – such as emergency service levies, transfer duties and import tariffs – might be reasonably labelled ‘microtaxes’, as they generate very small amounts of revenue. However, the regulatory burden they impose is great, and in some cases the deadweight loss to the economy can exceed the revenue generated. This is especially challenging for businesses with national operations, which need to comply with all Commonwealth and state tax regimes.

Many taxes and levies also feature complex qualification and/or deduction rules which greatly increases compliance burdens. A notable example of the Research & Development Tax Incentive (RDTI), which has complex eligibility rules for the entity conducting the R&D, the R&D activity performed, and the expenditure incurred. These rules distort R&D investment decisions towards tax management rather than innovation objectives, and impose compliance burdens that consume a nontrivial share of the RDTI tax offset. Many other examples abound.

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?

Principles for good regulatory design are that regulations should be precise, consistent, stable and proportionate. Regulations which meet these criteria support business efficiency and growth.

Some regulations are imprecisely drawn, leading to ambiguities regarding how a business should implement reporting and compliance. This greatly increases compliance cost on businesses, administration costs on regulators, and risk for business decision making. An example are the provisions in the Modern Slavery Act, which are imprecise regarding the specific obligations and reporting requirements expected on business. The consequence of this uncertainty is that a small company is confronted with multiple and differing Modern slavery compliance documents, despite not being specifically subjected to the legislation.

Many regulations are not consistent with each other, raising the overall compliance costs of the regulatory ecosystem. An example is the concept of a small business, which is subject to many different definitions across both Commonwealth and state policy settings. Inconsistent definitions can also pose reporting complexities, with similar regulations requiring different reporting standards for common concepts. While it is not always possible to align definitions due to policy objectives, as a principle definitions should be common wherever possible, and aligned to produce only small differences where such difference are required.

Repeated and piecemeal changes to regulatory settings increases compliance costs for business and administrative costs for regulators. Frequent updates are sometimes the result of in-built review periods mandated by legislation, while in other cases reflect the discretion of regulatory agencies. Good regulations should be updated only when, and only upon the schedule required for, the achievement of the policy objectives of the regulation.

Many regulatory regimes impose compliance costs which are disproportionate to the policy objectives of the underlying regulation. An example is the recent adoption of a definition of an Australian business for Commonwealth procurement purposes. This will impose significant informational and reporting requirements for all businesses seeking to participate in procurement as a precondition for tendering. As the policy itself notes, this data on business ownership structures is being sought for the sole purpose of information collection by government, with no material policy decisions attached to the collection of that information. Compliance costs should only be imposed on businesses only to the extent proportionate to the benefits such costs bring.

2. How has your regulatory burden changed over time?

Measuring regulatory burden is an extremely difficult task, and Ai Group is not aware of any reliable methods by which it can be estimated across the economy. Much of the complexity arises from the industry- and business-specific nature of regulatory burden, leading to wide variations between policies.

Anecdotally, businesses universally report that regulatory burden is increasing due to the steady increase in number of regulatory regimes, and the increase in complexity of those regimes over time. Frequently are regulations established or made more complex; rarely are they abolished or simplified.

An emerging and insidious form of regulatory burden is data collection, particularly problematic because it does not appear to be subject to Regulatory Impact Assessment procedures. From Workplace Gender targets to Ransomware attacks and electrical product registrations, the requirement for companies to prepare annual or incident reports under the cover of information is broadening and appears to have no limit.

An initial step in assessing regulatory burden would be the establishment of an inventory of the major Commonwealth and state regulatory regimes in Australia. To our knowledge no such research exercise has been systematically conducted. In its absence it is very difficult to establish either the overall scope of regulatory burden, the areas of the economy in which it is highest, or its change over time.

It would be highly useful if the Productivity Commission developed such an inventory as part of this inquiry (similar to its inventory of industry assistance measures collected as part of the annual Trade and Assistance Review). This would function as a national resource which all parties involved in the development of regulations could use an evidence-base for effective policymaking.

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?

   Our answer at [Q1] outlines the features of regulations which constrain business efficiency and growth. These comprise regulations which are imprecise, inconsistent, unstable and/or disproportionate to objectives.

   An additional dimension of regulatory burden which should be considered is its propagation through supply chains. There are many regulations that, while imposed on a small number of businesses, originate requirements that the target business needs to ‘pass on’ to other non-regulated businesses in the supply chain. Modern Slavery reporting is one example, where regulated entities are required to seek information and indirectly report upon the activities of their suppliers. This generates the need for the regulated entity to function as a private quasi-regulator of its supply chain: establishing its own regulatory requirements with which supplying businesses must comply.

   Supply chain propagation greatly increases the burden of a regulatory regime. Compliance costs cannot be assessed only for regulated entities, but also for the subsequent requirements passed on to further entities. It can increase the problem of regulatory inconsistency, where regulated large business implement supply chain requirements in different ways, forcing their SME suppliers to comply with multiple different quasi-regimes for the same ultimate purpose. It can also lead to burden magnification, where a regulated entity imposes more strict requirements on its supply chain ‘just in case’ the regulator might seek additional information.

   Regulatory design in Australia rarely pays attention to the realities or impacts of supply chain propagation. It results in overall regulatory burden significantly greater than anticipated during initial policy design. In many cases, a regulation which is proportionate in its first-order effects becomes grossly disproportionate once the second-order effects from supply chain propagation are considered.

   Regulatory design, implementation and evaluation should all make the second-order effects of supply chain propagation a primary concern.