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Productivity Commission
4 National Circuit
Barton ACT 2600

Five Pillars Secretariat

**SUBMISSION ON PC INTERIM REPORT: CREATING A MORE DYNAMIC AND RESILIENT ECONOMY -
CORPORATE TAX REFORM TO SPUR BUSINESS INVESTMENT**

Attached is the body of my submission on the tax component of the above interim report of the Productivity Commission. Following is a brief summary of the submission's contents.

The report's proposals

The interim report:

- proposes a fundamental change to our system of company taxation that adds a separate 5% "net cashflow tax" (NCT) to our current company income tax arrangements and reduces the company tax rate to 20% for small and medium-sized companies – with the prospect of expanding the NCT over time to fund broader "reductions in company income tax"; and
- considers that this change represents "the optimal approach to company tax" and corporate tax reform is one of the "biggest levers" for increasing investment and thereby productivity.

Effects of the proposals

In relation to the NCT itself:

- the NCT on its own would likely have minimal impact on pre-tax investment decisions;
- many small companies would be unlikely to be profitable enough to pay any NCT, though still being subject to NCT administration/compliance requirements;
- at the other extreme, for large companies, the NCT could operate very much like a 'pure' cash flow tax with NCT paid on their usual positive (non-financial) annual cash flows;
- despite such differences, all companies operating when the NCT is first introduced would require an up-front NCT "starting balance" deduction – matching current market value of their future non-financial flows. That deduction, while reducing NCT revenue, would offset what would otherwise be a 5% capital levy imposed on these existing companies (with even the least profitable otherwise paying NCT on up-front positive non-financial cash flow).

In relation to the proposed combination of NCT and company income tax:

- the tax-neutral outcome of the NCT in isolation is not maintained when the NCT is simply added to company income taxation – without blending NCT and income tax in a way that recognises the effect NCT has on company cash flow and value;

- that is particularly relevant to large, profitable companies whose income tax rate is not to be reduced;
- for small, marginally profitable companies, the proposal to allow them to write off NCT losses against income tax profits or liabilities would hollow out their income tax payments.

Shortcomings of framework underlying the proposals

The report does not acknowledge the investment-neutrality properties of income taxation. This lack of recognition:

- means the report appears to be unaware of the non-neutral way it proposes that the NCT be imposed in addition to unchanged company income taxation; and
- leads to the report's assumption that investors' required investment returns after income tax need to match their required returns before tax in order not to distort investment decisions. That assumption, in turn, raises questions over the way the report uses rate of return analyses to support its proposed new system and perhaps even its general equilibrium modelling.

Alternative design

The interim report restricts its proposals for tax reform to the structure of corporate taxation. Taking a somewhat broader view, the commission may wish to consider alternative design that has annual company taxable income always integrated with shareholders' personal tax assessments even when retained for investment. This integration design which upgrades our full imputation system would:

- blend holistically with our income tax system and reduce biases that militate against investment activity going to where it is most productive; and
- raise tax revenue to fund reductions in the associated single company tax rate that would then be set on the basis of how much to tax the inwards foreign equity investor.

Past broad tax/financial reviews both here and overseas have viewed this alternative as the theoretically ideal corporate tax design, though pointing to practical design issues that need to be resolved. Recent local publications aimed at resolving those issues and provisions of similar design that apply here to some trusts, as well as our robust imputation system and general capital gains tax regime, mean that Australia is uniquely placed to consider upgrading imputation to integration.

Conclusion

The commission may wish to consider recommending that both its ultimate redesign of corporate taxation and the alternative of upgrading of imputation to integration be subjected to Treasury's integrated tax design process. That process brings together policy advisers, tax administrators and legislative drafters early on in redesign development.

Yours faithfully

Wayne Mayo
Tax Economist

**PC INTERIM REPORT: CREATING A MORE DYNAMIC AND RESILIENT ECONOMY
CORPORATE TAX REFORM TO SPUR BUSINESS INVESTMENT**

INTERIM REPORT'S APPROACH

As reflected in the title of its tax component, the interim report sees: increased investment as crucial to improving our productivity; and, the corporate tax system as one of the “biggest levers to encourage investment and productivity” (p 1).

The interim report argues that our current corporate tax regime distorts investment and restricts investment and productivity because of, for example: the dampening effect of high statutory company tax rates on inwards international investment; the regime’s taxing of both normal and above normal profits; and, companies not being able to deduct capital expenditures immediately (while also noting that, with interest deductibility also allowed, immediate write-off would result in large tax revenue losses and subsidies to business investment).

Consequently, the report recommends moving from the current corporate tax system by making the following changes.

- Lower the company tax rate to 20% for small to medium companies. Large companies would continue to attract a 30 % tax rate.
- Introduce a 5% “net cashflow tax” (NCT) for all companies (“rewarding companies” for, and so be “more encouraging” of, capital expenditure because of immediate write-off).
 - Cash refunds would not be provided by government for negative NCT cash flows (NCT losses) – losses would, if necessary, be carried forward with interest (uplift) to be offset against “tax liabilities” (p 19) of NCT or company income tax – or, perhaps, company income tax “profits” (p 24). Uplift at the 10-year government bond rate (LTBR) is being considered.
 - Franking credits are proposed to continue to be calculated based on the amount of company income tax that has been paid – with views being sought on this and the NCT uplift rate.
 - With financial transactions excluded from the NCT, views are being sought on how to tax financial services activities.
- Expand the NCT over time to “fund broader effective reductions in company income tax, depending on an evaluation of the initial reform” (p 7).

Overall, the interim report suggests a system that combines company income tax and NCT is the “optimal approach to company tax” (p 7). It considers increased capital investment, boosting productivity, would result from: increased retained earnings, foreign inwards investment and after-tax returns resulting from the reduction in the company tax rate for small and medium companies; plus the general incentive provided by the immediate write-off of capital expenditure associated with the NCT.

The interim report has narrowed its tax proposals to just corporates. Nevertheless, it considers that, by drawing on general tax system principles (efficiency, equity, simplicity) through a “whole-of-tax system lens”, the design changes proposed would “increase economic dynamism and resilience in Australia, while remaining true to good tax system design”. (p 60)

BACKGROUND ON PRODUCTIVITY AND TAXING INVESTMENT PROFITS

People put money into investment opportunities either directly or indirectly via collective investment vehicles like companies and trusts. They are seeking best possible returns from their investments (capital outlays producing future income). The year-by-year income (commercial profit) from each investment comprises any annual gross receipts obtained less annual costs (all used up in the year) plus the annual change in value of the investment's assets and liabilities.

Absent any profit taxes, by seeking best available returns, these investment dollars are going to their most productive uses (environment issues aside). Productivity from land, labour and capital drawn in by these investments should be maximised. The resulting pattern of investment – not the level of investment *per se* – brings out the best of productivity overall. That is consistent with the commission's view on outcomes in a trading system free of tariff and non-tariff barriers.

Ideally, the design of profit-related taxes to raise revenue has minimal impact on pre-tax decisions on how and where to invest within Australia and what to invest in. Such decisions include funding sources (debt, new equity, retained earnings, and so on) and mode of investment (direct or indirect using different collective investment vehicles). The decision of businesses whether or not to incorporate, for example, would be made purely for non-tax reasons.

Imposing profit-related taxes does not lift productivity. It is how the taxes are designed that can minimise their negative impact on the productivity that would have been achieved in their absence – productivity impacted by such features as the flexibility of labour markets and the degree of unnecessary regulation (discussed elsewhere in the interim report).

Having minimal impact includes not diverting global investment flows away from Australia with its associated potential negative impact on productivity. Particularly relevant to such diversion is the level of the rate of company tax or dividend withholding tax taken out of company dividends flowing to inwards foreign investors.

Against this background, one way of assessing the quality of the interim report's tax proposals has three phases:

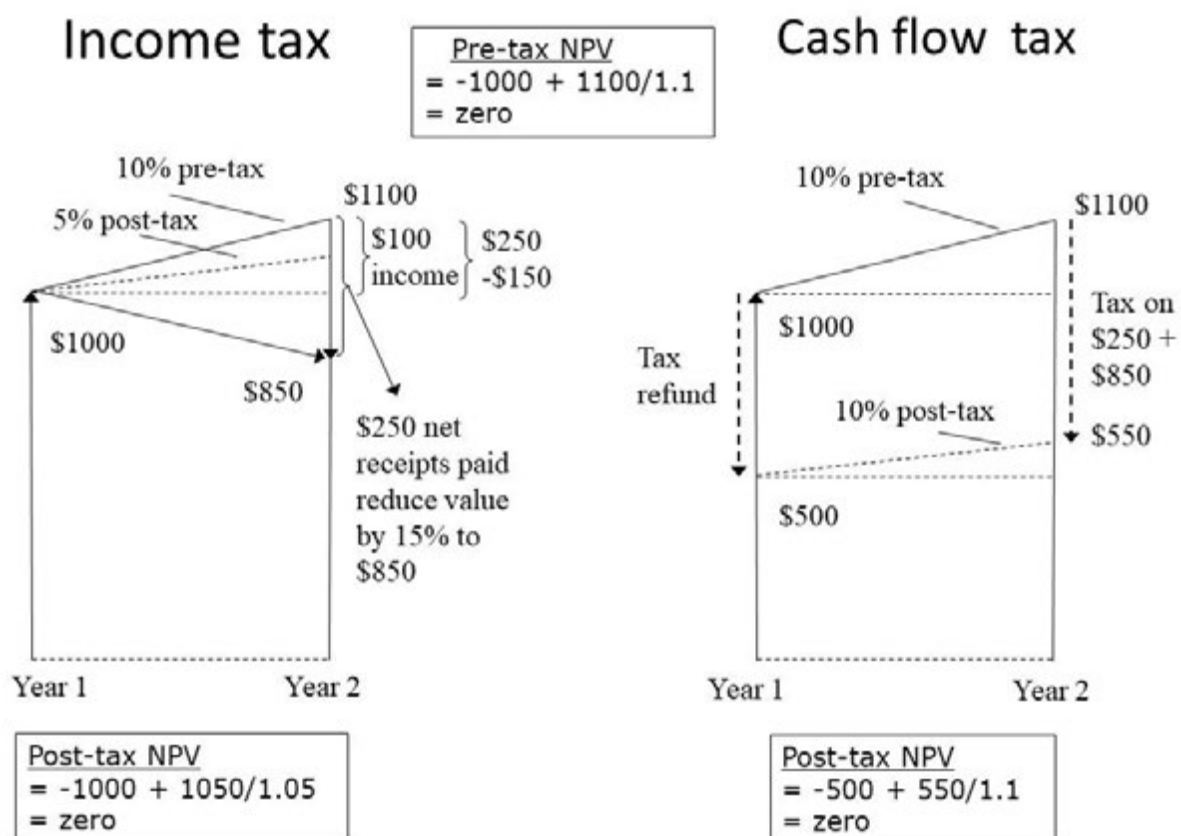
1. first, look at the theoretically-ideal design of each of the two taxes in the proposals that minimises its impact on investment decision-making – one applying to investment cash flows, the other to investment income (which also applies to wages income, with local investors' annual income from many sources brought together in their annual tax returns);
2. second, look at the theoretically-ideal way of combining the two 'pure' taxes, again so as to minimise investment distortions; and,
3. third, against the background of the first two phases, assess the interim report's proposed NCT and way of combining it with our full imputation system of company taxation.

Phase 1: investment-neutral design of income and cash flow taxes

Just before end Year 1, an investor puts \$1000 into a widget-producing machine (which could be via the report's *Widgets* company). At end Year 2, the value of the investment has increased by 10% to

\$1100 reflecting: \$250 net receipts from sales of widgets produced during the year less maintenance and other operating costs; plus, a \$150 reduction in value of the widget-producing machine because of wear and tear (which causes an ongoing 15% annual decline in future net receipts). The investor sells her interest in the machine for \$850 at end Year 2 after receiving the \$250 of net receipts.

The following 'neutrality chart' illustrates the separate operation of both pure cash flow and income taxation on the investment, each applied with a 50% tax rate – as well as the investment-neutrality properties of both taxes.



The neutrality chart has 10% pa as the 'going' interest rate, the rate at which investors are able to borrow and lend. That is the rate (unique risks aside) that investors use to discount expected future pre-tax investment flows back to the present to help establish the viability of investing. It is the inflation-affected nominal interest rate that includes any impact of income taxation in our small country with its open capital market part of the fluid worldwide financial markets.

The going interest rate here does not include any possible grossing-up effect on pre-tax returns required by our companies as discussed in the 'Henry review'¹. That affect is due to a country's excessively high company tax rate that diverts fluid global funds elsewhere and is therefore is not

¹ Australian Treasury, *Australia's future tax system*, report to the Treasurer (K Henry, Chairman), Part Two: Detailed analysis, volume 1 of 2, Australian Government, December 2009 (Available at <http://taxreview.treasury.gov.au>), p 152-153.

relevant either to the design of our imputation company tax system or of our domestic income tax base.²

Discounting the \$1100 expected in Year 2 (\$250 net receipts plus \$850 sale value) at 10% back to Year 1, gives \$1000. That suggests that a \$1000 investment in the widget machine is just viable before tax. The investment's pre-tax net present value (NPV) is zero, or $-\$1000 + \$1100/1.1$.

The neutrality chart shows how each of the two taxes affects the viability of this marginal planned investment. It illustrates the annual impact of each tax on the individual investor without regard to the investor's particular mode of investing.

Income tax

The interim report does not seem to appreciate the tax-neutrality properties of income taxation. Having to wait for capital expenditure to be written off, as opposed to getting the immediate write-off of cash flow taxation, is presented as something of a hand break on investment activity.

However, the neutrality chart illustrates how two features work together to provide investment neutrality from pure income tax design. Such design sees investors taxed on the annual economic income, or commercial profit, of their investments. Annual commercial profit comprises net receipts plus annual change in value of investment assets (and liabilities). The two investment-neutrality features are as follows.

1. The investor in the neutrality chart is taxed on the machine's \$100 of annual commercial profit, comprising \$250 net receipts (gross receipts less immediate deduction for current costs) less \$150 decline in asset value. Income tax depreciation allowed at 15% pa matches the actual decline in asset value. This means commercial profit is reduced after tax in proportion to the investor's 50% tax rate: from \$100 to \$50. Thus, the Year 2 payout is reduced from \$1100 pre-tax to \$1050 post-tax.
2. Given the 50% tax rate, the investor's after-tax discount rate becomes 5% pa: the 10% pre-tax rate reduced in proportion to the tax rate. That is because income tax applies to investment income across all alternative sources. Before tax, the investor could earn 10% pa interest from the financial market. After 50% income tax, the investor earns 5% pa interest.

Bringing these two features together, post-tax NPV for the investor remains at zero: $-\$1000 + \$1050/1.05$. The marginal viability of the investment need not be affected by the income tax. Swan, for example, explains the "apparent paradox that a tax which distorts consumption-savings decisions does not also distort investment decisions"³. He says, "Ultimately, the neutrality of the tax can be seen to arise from the fact that while returns are taxed the opportunity cost of funds is reduced in the same proportion"⁴. Samuelson⁵ derives the same result.

² In addition, the grossing-up effect, which must spread across both the unincorporated and incorporated sectors of a given commercial activity, will be lessened by a number of factors, such as; foreign investors using debt rather than equity or accessing credits for our company tax against their home countries' tax bill.

³ Swan P, "Income taxes, profit taxes and neutrality of optimizing decisions", (1976) 52, *Economic Record*, June, p 172.

⁴ Swan, above, p 172.

The consumption/saving distortion from income taxation comes from the very fact that the income from investing (or, saving) is being taxed. The welfare 'damage' of income taxation measured by modelling might be expected to reflect the impact of this general distortion. With such measures, it is important that the modelling factors in the impact that income taxation has on investors' discount rates⁶ - rather than embedding an investment-neutral requirement that has required post-tax return matching pre-tax returns (the requirement suggested on pages 61-62 of the interim report, for example).

Finally, the neutrality chart not only illustrates the investment-neutrality properties of income tax via unchanged investment NPV. The neutrality chart also underpins the idea that well-designed income taxation can reduce the general 10% pa pre-tax return (again, risk aside) across alternative marginal investment to a 5% pa return everywhere for the investor on a 50% tax rate. Regardless of the area of investment – financial, property, mining, manufacturing, widgets, and so on – from tax-neutrality and, therefore, efficiency/productivity perspectives, design of the income tax base would ideally achieve such a relationship between pre- and post-tax returns.⁷

Certainly, to reiterate, the quality of income tax design cannot be judged, as the interim report seems to do, on the degree to which after-tax investment returns align with pre-tax returns.

Worked examples showing tax-neutral outcomes for investments in wasting assets where tax depreciation matches actual decline in value may be found in Mayo⁸ and 'Draft White Paper'⁹. The 'Ralph platform' discusses "the mechanisms that might be used to achieve ... in a consistent way across the full range of wasting assets" effective life depreciation "directed at allowing the taxpayer to deduct an estimate of the actual decline in value of the asset in each year."¹⁰ That discussion was a prelude to our unified effective-life depreciation system, recommended by the 'Ralph review'¹¹. That unified system subsumed a multitude of write-off regimes and replaced accelerated depreciation¹².

⁵ Samuelson P, "Tax deductibility of economic depreciation to insure invariant valuations", (1964) 72 *Journal of Political Economy*, December, 604-606.

⁶ Swan, above n 3, p 173, goes beyond the partial equilibrium nature of the neutrality chart to discuss briefly some general equilibrium effects of taxing investment income.

⁷ See Mayo W, *Taxing investment income: without affecting worldwide investment decisions*, Kyscope Publishing, 2011, Chapter 4, and Mayo W, *Brad – Tax Policy Advisor Extraordinaire: reforming the taxation of investment income*, Kyscope Publishing, 2025, Chapters 4 and 5. (Both available at: www.kyscope.com.au.)

⁸ Mayo W, "(Tax) Depreciation and Inflation: Some Practical Observations", *Economic Papers*, 1984, 3 (4) December, p 36 (Table 1). Available at www.kyscope.com.au.

⁹ Australian Government, Reform of the Australian Tax System, *Draft White Paper*, AGPS, Canberra, 1985, Chapter 19.

¹⁰ Review of Business Taxation, *A Platform for Consultation*, "Building on a strong foundation, The taxation of investments", Discussion Paper 2, Volume I, AGPS, Canberra, February 1999, Chapter 1, p 81. Available at: <https://webarchive.nla.gov.au/awa/20180316084138/http://rbt.treasury.gov.au/> (via 'Publications' link).

¹¹ Review of Business Taxation, *A Tax System Redefined*, "Overview, recommendations, estimated impacts" (J Ralph, Chairman), AGPS, Canberra, July, 1999, Sections 8. Available at: <https://webarchive.nla.gov.au/awa/20180316084138/http://rbt.treasury.gov.au/> (via 'Publications' link).

¹² In the early 1980s across-the-board accelerated 10/5/3 depreciation was allowed, as well as a 20% investment allowance. Distorted investment decision-making resulted relating to, for example: repairs versus asset replacement; short-lived versus long-lived assets; and, leasing versus borrowing to buy (the Eraring power station being sold and leased back is an illustration of the effects). Lost productivity resulted.

Cash flow tax

Planned investments. The neutrality chart shows that, with a ‘pure’ cash flow tax (CFT)¹³, immediate write-off is allowed for the \$1000 of capital expenditure on the widget-producing machine (in sharp contrast to income tax design). It also has the investor immediately receiving back \$500: the value of the associated tax loss (negative cash flow) equal to the \$1000 loss times the tax’s 50% tax rate (the rate of the CFT, not the investor’s personal income tax rate). That \$500 immediate ‘full loss offset’ comes either from a government refund or from the writing off of the loss against positive cash flow from the taxpayer’s other investments in the cash flow tax net.

The draft report suggests that this immediate write-off would encourage investment – even though, minimising adverse efficiency or productivity effects involves collecting tax in ways that have minimal impact on pre-tax investment decisions. The neutrality chart shows what is on the other side of this immediate full loss offset: \$550 of tax paid on all the positive cash flow at end Year 2 from the annual net receipts produced and the sale price of the widget machine. As with the pure income tax, the CFT is aimed at minimising the impact on decision-making in the absence of the tax, not somehow improving productivity because of its immediate expensing of capital expenditure.

The CFT maintains the 10% pa pre-tax return after tax. That is because it does not tax the going 10% pa return at all. Discounting at 10% the \$550 of tax at end Year 2 back to end Year 1 gives \$500 – the amount of tax revenue given up at that time. From the perspective of the investor using an unchanged 10% pa discount rate, no net tax is payable at all on a planned investment in widget machines. Post-tax NPV matches the zero pre-tax NPV. Rather than encouraging investment, the tax should not affect marginal investments. That is the same aim of pure income taxation, even though that does tax the normal return (10% pa in the neutrality chart) of the marginal investment.

Under the CFT, only expected cash flows in Year 2 that produce a return higher than 10% over the year would be viewed as being taxed by the investor applying a 10% pa discount rate. Then, post-tax NPV would equal pre-tax NPV cut in proportion to the tax rate. As the interim report notes, such a cut in NPV could affect global investors who are assessing investments with similar above-normal profits in Australia and another country if the other country did not impose an additional CFT – an effect particularly relevant to our large, profitable companies.

Up-front cash refunds for losses under a CFT could be replaced, while seeking to maintain tax-neutral outcomes, by carrying any CFT losses forward with interest (uplift). As implied in the interim report, in circumstances where it is certain that the value of those uplifted losses will eventually be fully recouped, the uplift rate would be the long term bond rate (LTBR). Again, this delayed full loss offset would be effected either by the uplifted loss being offset against positive cash flow or by government providing a refund equal to the uplifted loss times the tax rate, if necessary.

Under CFT with delayed full loss offset, investors need to take into account two assets when assessing investment viability: the risky investment asset as usual; plus, a risk-free asset comprising ‘loans’ to government for up-front CFT refunds not paid for in each year of negative cash flow – with

¹³ This is often termed a ‘Brown’ tax, after Brown, E. C., “Business Income Taxation and Investment Incentives” in *Income, Employment and Public Policy, Essays in Honor of Alvin H. Hanson*, Norton, New York, 1948. The interim report calls this tax a “two-sided net cashflow tax”.

subsequent acquittal of those loans occurring over time. Mixing together the cash flows of the two assets leads to faulty investment evaluation.¹⁴

Existing investments. Investments that are already underway when a CFT is introduced deserve particular attention.

The investor in the neutrality chart would not be happy if, having invested the \$1000 in the widgets machine at end Year 1, the cash flow tax were unexpectedly introduced before end Year 2. The investor would be taxed on the positive Year 2 cash flow, leaving the investor with a net \$550, but would have got no tax reduction for the up-front negative \$1000 cash flow. The post-tax discounted value of the \$550 at end Year 1 is then \$500. Absent a \$1000 up-front deduction, a capital levy equal to the 50% CFT tax rate would have been imposed on the investor's existing investment.¹⁵

Phase 2: blending pure cash flow and company taxes

The tax-neutral outcomes of both the pure cash flow and income taxes would ideally be maintained when blended together.

CFT with immediate loss offset. With the CFT applied before income tax, it may seem logical simply to add any government refunds for negative cash flows to taxpayers' income tax assessments and allow as income tax deductions payments of CFT. That design would not, however, achieve a blended tax-neutral outcome.¹⁶

Blended tax neutrality would require post-CFT cash flows to feed into investors' income tax assessments.¹⁷ In the neutrality chart, that would see post-CFT flows with zero NPV feeding into income taxation. That would maintain NPV at zero after both taxes (or 10% pre-tax return, maintained through the CFT and cut to 5% by income taxation). That mirrors the way cash flows after our Goods and Services Tax (GST) feed into businesses' income tax assessments (that is, purchases and receipts net of GST refunds and payments, respectively). Cash flow taxes and the GST are all part of the broad expenditure tax family.¹⁸

The CFT part of the neutrality chart illustrates how, in this tax-neutral blending of the two taxes, the presence of the pre-income tax CFT shrinks the cash flows that feed into income taxation. Mayo demonstrates that outcome in tabular and graphical form.¹⁹ With marginal investments, cash flows being subjected to income tax are shrunk by the CFT even though no CFT tax is paid.²⁰ It is the more

¹⁴ Mayo W, *Taxing resource rent: concepts, misconceptions and practical design*, Kyscope Publishing, 2013, pp 55-60. Available at www.kyscope.com.au.

¹⁵ See Swan, above n 3, p 176, and Mayo (2013) above, pp 37-39.

¹⁶ See Mayo (2013) above, pp 169-176.

¹⁷ See Mayo (2013) above, pp 177-185. Table 20, p 185, shows zero NPV of a hypothetical mining project maintained through both cash flow taxation and income taxation – and 10% pa return maintained through cash flow taxation and cut to 7% pa by the investor's 30% income tax rate.

¹⁸ The commission's final report would benefit from an explanation as to how the NCT would blend with the GST with its immediate refunds for excess purchases (which do not include wages) over receipts.

¹⁹ Mayo (2013) above, Table 19 (p 182) and Figure 16 (p 183).

²⁰ In Mayo(2013) above, Table 20 (p 185) shows how a marginal investment before tax pays 40% less income tax year by year when a 40% CFT (providing no net tax revenue in discounted terms) and a pure income tax are combined relative to the situation in Table 18 (p 175) where no CFT applies.

profitable investments that contribute CFT revenue from the proportion of cash flows excised from income tax by the CFT.²¹

CFT with delayed loss offset. Under a CFT with delayed loss offset applied together with income tax, the risky project and risk-free assets not only need to be separated for correct investment evaluation. These two assets should ideally also be assessed separately for income tax purposes, with the risky investment asset treated as if a CFT with immediate loss offset were in place.²² In the likely event that the risk-free asset is not separately assessed for income tax purposes, the uplift rate would ideally be after-income tax LTBR (LTBR cut by the investor's income tax rate), not LTBR.²³

The 40% resource super profits tax (RSPT), based on design in the Henry review²⁴ and proposed in 2010 by the Australian Government²⁵, is a form of CFT with delayed full loss offset.²⁶ In contrast to ideal treatment, however, RSPT refunds and RSPT payments were proposed to be assessable and deductible for income tax purposes, respectively – with uplift set at LTBR (a level which few accepted or understood²⁷). The RSPT was to apply to existing companies and, consequently, the capital levy question was a significant issue with that tax.

Phase 3: assess the proposed NCT and its combination with our full imputation system

Income tax

The treatment of investments under our income tax base does not always match the tax-neutral ideal described in the neutrality chart.²⁸ Nevertheless, there has been much progress over recent decades to better align changing tax values applied in the law with changing actual values of investment assets and liabilities. Examples of this progress include the: (1) generally-applicable capital gains tax (CGT) regime, introduced on recommendation of the 1985 Draft White Paper and revised following the 1999 Ralph review²⁹; (2) system-wide sound treatment of depreciation (accrued capital losses) for wasting assets (consistent with the example used in the neutrality chart) following recommendations of the Ralph review; and, (3) regime for financial assets and liabilities (TOFA), first legislated in 2009, followed by ongoing legislative change.

²¹ See Table 26, p 207, in Mayo (2013), above n 14.

²² Mayo, above, n 14, pp 186-191. Table 21 (p 187) illustrates tax-neutral design with income tax applied to the risky asset and risk-free asset. Table 22 (p 190) compares tax revenue flows when loss offset applies either immediately or with delay.

²³ Mayo, above n 14, p 189.

²⁴ Australian Treasury, above n 1, recommendation 45.

²⁵ Australian Government, Australian Treasury, *The resource super profits tax: a fair return to the nation*, 2010. Available at: <https://catalogue.nla.gov.au/Record/4942197>.

²⁶ The interim report's nomenclature might have the RSPT classed as a "one-sided cashflow tax", as with its NCT, but that would hide the RSP's key feature of full loss offset.

²⁷ The separation of risky project and risk-free assets that was still required to demonstrate how project viability needed to be determined was only started to be communicated belatedly with the RSPT.

²⁸ The interim report notes the "distortionary" treatment of income tax losses. A particular difficulty there is that those losses are often not commercial (or economic) losses because, for example, accrued capital gains (the mirror image of depreciation) are often not included in annual taxable income.

²⁹ An inflationary 'slice' was initially excluded from realised CGT gains even though, providing inflation adjustments to only one asset class in our nominal income tax system and not assessing accruing CGT gains prior to realisation provides a doubling up of concessional treatment. Subsequently, the inflationary slice from realised gains was removed for companies and, for other taxpayers, replaced by exclusion of 50% of realised gains and losses.

Moreover, under our full imputation arrangements, when our companies distribute immediately to local shareholders taxable income from local sources (as franked dividends plus franking credits), those shareholders are taxed on the companies' initial annual taxable income at their personal tax rates. That outcome is consistent with our treatment of individuals investing directly or via unincorporated businesses or trusts – and the ideal treatment in the neutrality chart.³⁰

Net cashflow tax (NCT)

New companies. Viewed first in isolation, the NCT is not a pure CFT because the value of NCT losses is not guaranteed to be recouped.³¹ Nevertheless, design of the NCT is consistent with CFT design that seeks to raise tax revenue in a way that has minimal impact on investment decision-making (rather than, as suggested by the interim report, encourages investment).

Moreover, as the interim report notes, the NCT would operate like a CFT with immediate loss offset for many large or medium-sized companies that are highly profitable and operate across a variety of activities. And, for any such company that does realise temporary negative cash flows over a number of years, say, because of large capital investments, carry-forward of NCT losses with uplift may achieve the equivalent of delayed full loss offset. For companies in this situation, even given the risk of unrecouped NCT losses in NCT design, there is a case to be made for uplift at post-tax LTBR to apply to NCT losses being carried forward (assuming the risk-free asset is not subject to income taxation).³²

These circumstances would, however, likely not be applicable to a very high proportion of small to medium companies. For such companies, the implicit loans to government are very risky. As with the Petroleum Resource Rent tax (PRRT), uplift rates of LTBR or higher could be implemented with the NCT in an attempt to offset these risks. But, for many small to medium companies, regardless of the size of the uplift rate, there may never be sufficient future positive cash flows to fully offset the carried-forward losses.

Existing companies. When the NCT is introduced, as illustrated by the neutrality chart, absent extra deductions allowed up front ('starting base' or the report's "starting balance"), companies operating at that time would have a 5% capital levy imposed on them. That would be so even for small, marginally-profitable companies. Even such small companies would likely be cash flow positive at

³⁰ The interim report says, as does the Henry review (above n 1, pp 178-179, for example), that our imputation system "treats debt preferentially over equity financing" (p 23) because interest payments attract tax deductions. Interest payments on a company's bonds paid out of the company's profits are deductible to the company. But, those payments are taxed in the hands of the bondholders. And, with full imputation, dividends paid out of local profits are taxed in the hands of shareholders receiving them. Issues relating to interest withholding tax on foreigners' debt aside (unrelated to imputation), there is one layer of tax on returns to both equity and debt funding. In fact, under imputation, delayed tax on retained company income may provide a bias towards local equity funding. The interim report (p 68), as does Swan (above n 3, p 176), explains how allowing deduction for corporate equity would turn company income tax into a cash flow tax.

³¹ Traditional nomenclature, drawn from local literature (including reports of the Industries Assistance Commission, the Productivity Commission's precursor) might call the NCT a 'Corporate Rent Tax', or CRT.

³² Mayo W, "Combining resource rent and income taxation for neutral impact", *Australian Tax Forum* 34 (3) pp 585-627, 2019 (available at www.kyscope.com.au) discusses how, under design that combines income tax and an 'impure' CFT (rent tax) with carried-forward losses, the uplift rate could be set at after-tax LTBR in circumstances when, at the time of investment decision-making, it is likely that the value of carried-forward rent tax losses would be recouped fully.

the time. Absent suitable starting bases, as with more profitable companies, they would be paying NCT immediately.

Again, as illustrated by the neutrality chart, removing this initial 5% impost would require positive market values of expected future non-financial cash flows of existing companies to be allowed as deductions.³³ All of this would not be an insignificant administrative task. And, allowing such starting bases for all companies which have positive up-front values of future flows would significantly reduce expected future NCT revenue.

Not providing the extra deductions would certainly raise extra tax revenue. That raises the question what the interim report's revenue estimates assume for starting base allowances.

The report raises the prospect of the NCT rate being increased in stages beyond 5%. The capital levy would be an issue with each increase. It is no surprise that the project-based PRRT initially only applied to new projects and projects likely to be very profitable.

Imputation franking credits. Our imputation system is designed to have company taxable income taxed at shareholders' marginal tax rates when distributed as franked dividends plus imputation credits. In contrast, the initial tax rate of the NCT is to be set at the fixed 5% rate. That is the rate of tax that government is seeking to make on above-normal profits. Under the NCT, government is taking a share of companies' non-financial cash flows. It is effectively taking a 5% stake in large, profitable companies, for example, and would be relying on the investment nous of the companies for it to achieve net tax revenue from that stake. As the interim report posits, payments of NCT somehow attracting imputation-style franking credits does not fit with NCT design at all.

Combining NCT and income tax

The proposed way of bringing together the NCT and our company income tax system does not accord with the tax-neutral ideal and potentially compromises company income tax collections.

Compromising income tax revenue. The possibility of NCT losses being "offset against" income tax "liabilities" or income tax "profits" is proposed.³⁴ That proposal appears to be aimed at improving the tax-neutrality properties of the NCT. But, the neutrality chart highlights the impracticalities of mixing the tax bases of two very different taxes in such a way. Even at the initial 5% NCT rate, 5% of the \$1000 of Year 1 NCT losses would absorb all of the chart's \$50 of income tax liabilities (even with the 50% tax rate in the chart) and half the \$100 of income tax profits. Seeking a tax-neutral outcome for the NCT in this way could severely undermine company income taxation.

More specific numbers can be put on tax revenue problems that would arise with such mixing together of the two tax bases by running out the investment in the neutrality chart over 5 years. The investment in the widget machine would continue to return 10% pa before tax and would be sold for \$444 at the end of the 5 years.³⁵

³³ See also Swan, above n 3, p 176 and Mayo (2013), above n 14, p 37-42.

³⁴ The alternative suggestion of offset against NCT "liabilities", rather than NCT profits, does not seem consistent with any type of CFT design.

³⁵ See Table 2 in Mayo (2011), above n 7, p 36 (where 47% income tax rate is used).

- On the income tax side, the NPV of 30% income tax paid over the 5 years would be a discounted **\$79**, with discounting at 10% pa (or \$112 total tax).
- On the 5% NCT side, the up-front loss would be \$50, to be carried forward with 10% pa uplift. There is easily sufficient taxable income or income tax liabilities available over the 5 years to fully absorb carried-forward NCT losses. Consequently, regardless of which income tax stream were used to offset NCT losses, the NPV of NCT payments would be zero, again with discounting at 10% pa.
- However, the NPV of income tax payments would be cut from **\$79** to either **\$69** (\$99 total) or **\$58** (\$79 total) with NCT losses applied to taxable income or tax liabilities, respectively.
- This shows that, by mixing the NCT and income tax bases in the way proposed, even companies making commercial profits that only achieve the 'normal' 10% pa pre-tax return would have their income tax bills reduced significantly. And, even less profitable small to medium companies (with no prospect of paying NCT), would have their income tax payments hollowed out by this proposed design feature.

Affecting investment decision-making. Ignoring the proposed mixing of the two tax bases in NCT design, combining NCT and income tax in the manner proposed does not accord with either ideal, tax-neutral design or typical practical design. Thus, even though the NCT seeks to cut 5% off pre-tax investment flows, those flows are still to be assessed for income tax purposes. That is the case even for large, highly-profitable companies for which the NCT would operate as a pure CFT. Even for them, post-NCT flows are not proposed to feed into income tax assessments.

And, unlike the PRRT and RSPT, NCT payments are not proposed to be a deduction for income tax purposes. For large companies, such NCT deductions could act as a less ideal alternative to having post-NCT flows pass through to income taxation. For small companies, this would be the only practical alternative because the high risk of unrecouped NCT losses means the ideal passing-through of post-NCT flows is not practicable.

Consequently, proposed design simply has NCT as a tax on companies in addition to income tax still based on pre-tax cash flows (to help fund reductions in the company tax rate for small to medium businesses). Thus, those small to medium companies not sufficiently profitable to pay NCT at all would be assessed for income tax as usual – after adhering to required NCT accounting. Their taxable income would continue to attract the applicable company tax rate for as long as they hold the after-tax profits at the company level.

The non-neutral, or distortionary, impact on investment decision-making of this adding of NCT to unchanged company income taxation may be illustrated using the interim report's Table B.7 (p 65) – drawing on the neutrality properties of income taxation shown in the neutrality chart.

Table B.7 shows how the NCT, operating as a CFT with immediate loss offset, does not change the discounted total tax paid by a large company when the assumed pre-tax return of an investment by the company (10% pa) matches the discount rate used to compare tax payments. That outcome is assured mathematically: NCT payments from the investments must discount at 10% pa to the up-front NCT 'refund' (value of the investment's up-front negative cash flow recouped immediately).

Table B.7, however, does not show how the interim report's proposed tax design performs in terms of its impact on pre-tax investment decision-making. The neutrality chart shows what the effect

would be on the pre-tax 10% pa return and zero NPV of the investment in Table B.7 were NCT and pure income taxation blended in a tax-neutral way:

- after NCT, 10% pa return and zero NPV (discounting at 10%) would be maintained;
- after post-NCT cash flows are fed into 30% income taxation, 7% pa return and zero NPV (discounting at investors' post-income tax 7% pa rate) would result;
- thus, a 7% pa return and zero NPV (with discounting at 7% pa) after-all taxes is the benchmark against which to compare alternative designs using the report's Table B.7.

Against that benchmark, Table 1 illustrates the non-neutral impact of the proposed way of adding NCT to income tax for large companies.

TABLE 1

Company in interim report's Table B.7 subject to 5% NCT plus income tax with 5-year straight-line write-off of \$500,000 capital investment

Year	Pre-tax cash flow (a) \$	Income tax depreciation (b) \$	Taxable income (c) \$	Income tax payments at 30% (d) \$	Post-income tax cash flow (e) \$	5% NCT (f) \$	Post-all taxes cash flow (g) \$	Total tax revenue (h) \$
0	-500000				-500000	-25000	-475000	-25000
1	131899	-100000	31899	9570	122329	6595	115734	16165
2	131899	-100000	31899	9570	122329	6595	115734	16165
3	131899	-100000	31899	9570	122329	6595	115734	16165
4	131899	-100000	31899	9570	122329	6595	115734	16165
5	131899	-100000	31899	9570	122329	6595	115734	16165
NPV	Zero (i)			\$32,979(i)	\$1,471(j)	Zero(i)	-\$436 (j)	\$32,979(i)
IRR	10.0%				7.12%	10.0%	6.96%	
Sum				\$47,849		\$7,975		\$55,823

(a) As in Table B.7 of interim report.

(b) As in Table B.7 of interim report. Based on \$500,000 despite NCT's 5% cut.

(c) As in Table B.7 of interim report. Based on pre-tax flows despite NCT's 5% cut.

(d) As in Table B.7 of interim report.

(e) Column (a) less Column (d).

(f) 5% x Column (a), as in Table B.7 of interim report.

(g) Column (e) less Column (f). NCT taken from post-income tax, not pre-tax, flows.

(h) Column (d) plus Column (f), as in Table B.7 of interim report.

(i) Discounting at 10% pa pre-all taxes discount rate.

(j) Discounting at investors' post-income tax discount rate of 7% pa – that is, $10 \times (1 - 0.3) \%$ pa.

Table 1 applies the proposed design to the same pre-tax flows of the \$500,000 investment as in Table B.7 (producing a 10% pa pre-tax return) and the same straight-line depreciation assumed for income tax purposes. Total and discounted income tax and NCT are the same in Table 1 and Table B.7. But, there are differences in rate of return and NPV outcomes in Table 1 compared to the tax-neutral benchmark outcomes, differences which can be seen to arise from:

- first, a \$7.12% pa return and \$1,471 NPV after income tax – a better result than the benchmark outcomes only because generous straight-line write-off is applied, rather than economic depreciation (that tracks actual change in asset value ; and,
- then, when the NCT is added, the after-all taxes return and NPV are reduced to 6.96% pa and minus \$436, respectively. The worsening of outcomes reflects the non-neutral effect of income tax ignoring the effect NCT has on pre-tax investment cash flows and value.

In contrast, Table 2 shows changed outcomes when income tax with straight-line depreciation, is applied to pre-tax cash flows net of the up-front NCT ‘refund’ and subsequent annual NCT payments.

TABLE 2

Company in interim report’s Table B.7 subject to income tax with 5-year straight-line write-off of \$500,000 investment and taxable income based on cash flow after 5% NCT

Year	Pre-tax cash flow (a) \$	5% NCT refund/ tax paymts (b) \$	Cash flow after NCT (c) \$	Income tax deprec- iation (d) \$	Taxable income post- NCT (e) \$	Income tax paymts (f) \$	Post-all taxes cash flow (g) \$	Total tax revenue (h) \$
0	-500000	-25000	-475000				-475000	-25000
1	131899	6595	125304	-95000	30304	9091	116213	15686
2	131899	6595	125304	-95000	30304	9091	116213	15686
3	131899	6595	125304	-95000	30304	9091	116213	15686
4	131899	6595	125304	-95000	30304	9091	116213	15686
5	131899	6595	125304	-95000	30304	9091	116213	15686
NPV	Zero (i)	Zero (i)	Zero (i)			\$31,329(i)	\$1,398 (j)	\$31,329(i)
IRR	10.0%	10.0%	10.0%				7.12%	
Sum		\$7,975				\$45,456		\$53,431

(a) As in Table B.7 of interim report.

(b) 5% x Column (a), as in Table B.7 of interim report.

(c) Column (a) less Column (b).

(d) 20% write-off each year of \$500,000 Year 0 investment less \$25,000 NCT ‘refund’.

(e) From Year 1, Column (c) less Column (d).

(f) Column (e) x 30% income tax rate.

(g) Column (c) less Column (f).

(h) Column (b) plus Column (f).

- (i) Discounting at 10% pa pre-all taxes (and post-cash flow tax) discount rate.
- (j) Discounting at investors' post-income tax discount rate of 7% pa – that is, $10 \times (1 - 0.3) \%$ pa.

In Table 2, the after-all taxes return and NPV of the investment come out as 7.12% pa and \$1,398, respectively. These after-all taxes results again differ from 7% pa and zero NPV, but this time only because straight-line write-off is employed for income taxation rather than economic depreciation.

- Because income tax in Table 2 recognises the NCT's impact on pre-tax flows, total and discounted tax revenue in the table is \$2392 and \$1650 less, respectively, than in Table 1. Those differences are explained solely by the same respective differences in income tax payments between the two tables.
- The difference in income tax revenue between the two tables is consistent with no tax being paid in Table 2 on the normal return associated with 5% of the investment cash flows removed from the income tax base. That tax not paid is 5% of total income tax payments in the table – or, \$2392.
- If, alternatively, the investment in Table 2 had produced an above-normal return (above 10% pa assumed here), government would receive as NCT revenue all the above-normal profit associated with its 5% stake in the project.
- Going to the extreme, were the NCT rate set at 100%, no income tax would apply to companies at all and government would collect all of companies' above-normal returns, with normal returns subject to no tax.

To highlight more clearly the distortive nature of the report's adding of NCT to income taxation, Tables A1 and A2 in the attachment to this submission replace straight-line write-off in Tables 1 and 2 with economic depreciation. As a result:

- in Table A1, after both taxes the investment's return is 6.84% pa and NPV is minus \$1,906. Again, that illustrates the non-neutrality of the proposed NCT/income tax arrangements;
- in Table A2, after both taxes the investment's return is 7% pa and NPV is zero – as expected from the neutrality chart. This reflects design that is sympathetic to the impact that the NCT has on pre-tax cash flow (and, thus, value) of the investment by the company in Table B.7.

The non-neutral impact shown in Table A1 comes from the modest 5% NCT tax rate. A feel for the non-neutral impact the report's proposed design with a 40% NCT rate can be obtained by applying the design to the hypothetical mining investment of just \$1000 in Table 20 in Mayo³⁶. The table already applies economic depreciation and a 40% CFT. Substituting the report's design sees the 7% pa and zero NPV post-taxes results in that table become 5% pa and minus \$42.

This analysis contrasts sharply with that in the interim report of a similar investment with a pre-tax return of 10% pa and subject to income tax at a rate of 20% with straight-line depreciation allowed (Table B.1, pages 61-62). The interim report claims that the required return of the investment before tax would need to increase after income tax to 12.3% pa in order to achieve a post-tax return of 10% pa – thus “demonstrating the distortions in company investment decisions imposed” by company income taxation

³⁶ Mayo (2013), above n 14, p 185.

ALTERNATIVE COMPANY TAX DESIGN

The above lengthy, somewhat tortuous discussion might give the impression of support for a company tax system that combines NCT with income taxation in a way that is consistent with tax-neutral design – one which therefore minimises adverse effects on efficiency/productivity. In practice, if not somehow restricted to ‘profitable’ companies only, such a system would look very different across the spread of companies.

- At one extreme, large, profitable companies that are continually cash flow positive, would have company income tax levied on post-NCT cash flows – with NCT losses that arise temporarily uplifted at after-company tax LTBR. Those existing when the NCT is introduced would attract a starting base matching the value of their expected future non-financial cash flows.
- At the other extreme, existing small companies would still attract a starting base equal to any expected positive value of future non-financial cash flows. But, small companies generally would uplift NCT losses at, say, at least LTBR. And, any NCT that is paid would be an income tax deduction.

But there is a broader view of efficiency to be taken when considering company tax redesign.

Despite not being constrained so by the terms of reference, the interim report narrows its discussion to corporate tax design – even though it states that, given “Australia’s personal income tax system is beyond the scope of this inquiry, reforms to the dividend imputation system have not been considered” (p 69).

Taking more of a whole-of-system approach would help in framing possible corporate tax changes. Just like the investor in the neutrality chart, individuals investing in a wide range of circumstances currently face tax at their marginal tax rates on taxable income from their widget investment year by year; for example:

- individuals and sole traders investing directly;
- individual unitholders and beneficiaries of many fixed and discretionary trusts (trustees encouraged to distribute annually by the prospect of attracting the top personal tax rate on annual trust taxable income);
- individual partners who are taxed on their proportional interests in their partnerships;
- individual shareholders who receive distributions of annual taxed income (franked dividends) from their large, dividend-paying companies (including via dividend reinvestment plans), companies that recognise their shareholders’ needs with particular reference to those on lower tax rates (an incentive more significant when the company tax rate was aligned with the top personal tax rate for a short period)³⁷; and
- individual shareholders of closely-held companies who are paid distributions of annual taxed income in order to pay the costs of their everyday living.

³⁷ The Henry review, above n 1, pp 194-195, discusses related integrity benefits of imputation including how it encourages local companies to bring foreign profit-making home and discourages them from shifting local profits offshore.

Consistent with this, the neutrality chart provides a clear framework for company income tax design which has annual taxable income taxed at the tax rates of individual local shareholders. Under our full imputation system, however, that outcome can only be assured if companies immediately distribute annual taxable income.

- That is evidenced by widely-held ‘growth’ companies often only distributing low proportions of annual taxed income each year.
- Moreover, closely-held companies with high income shareholders, have incentive to retain income and distribute when shareholders face low, or zero, personal tax rates. Complex company-trust structures may be employed, with ‘bucket’ companies used to store and invest income³⁸ – with shareholders aspiring at one extreme to achieve zero tax on their stored company income (taking into account the delays involved), drawing on refundable imputation credits.

Such inequities and variations in timing of franked dividend distributions across individual shareholders are deviations from the tax-neutral framework reflected in the neutrality chart. To reiterate, under that framework, company income – in practice taxable income – would be taxed in the year it is earned at individual shareholders’ tax rates.

Integration of taxable income

The investment-neutral outcome of the neutrality chart could be achieved by upgrading our full imputation system to integration of taxable income. Integration design for companies has been lauded or recommended by several past local and overseas financial/tax reviews.

The Carter Commission, for example, concluded that, “After an exhaustive examination of the alternative methods of taxing corporate income ... we have come to the conclusion that ... full integration ... is without doubt the best system”³⁹. The ‘Asprey review’ referred to such design as “perhaps the theoretical ideal”⁴⁰ but concluded that there were practicalities to resolve. The ‘Campbell committee’⁴¹ recommended it.

Not long after the Campbell committee’s report, the Australian Government’s 1985 Draft White Paper saw its proposed move from classical company taxation to full imputation as a potential springboard to integration: “were an imputation system introduced it would provide an appropriate basis for extension to a full integration system were the practical difficulties of that system eventually adequately resolved”^{42 43}

³⁸ See, for example, Mayo (2025), above n 7, Ch3, p 8.

³⁹ Carter Commission, Royal Commission on Taxation, Queen’s Printer, Ottawa (1966) p 6.

⁴⁰ Taxation Review Committee, Final report, (Asprey review) (K Asprey, Chairman), AGPS, Canberra (1975) p 228.

⁴¹ Committee of Inquiry into the Australian Financial System, Australian financial system: final report of the Committee of Inquiry into the Australian Financial System (Campbell Committee) (J Campbell, Chairman) AGPS, Canberra (1981).

⁴² Australian Government, above n 9, p 199.

⁴³ Subsequently, the 1999 Ralph review (above n 11), while seeking consistent tax design across companies and trusts via imputation arrangements, retained integration design in its policy design principles.

Mayo attempts to address the practical difficulties noted in the Draft White Paper and elsewhere⁴⁴ and points out that Australia is in unique position to contemplate such a move because of its: (1) long successful experience operating dividend imputation; (2) across-the board CGT regime; (3) refundable imputation credits; and, (4) regime for attribution managed investment trusts (AMIT), which has many similar features to integration design⁴⁵.

Mayo also notes how, under integration design, the single company tax rate would be set on the basis of how much to tax the long-term inwards foreign equity investor⁴⁷ – with likely significant tax revenue savings from a move to integration able to be applied to such reductions.

Under integration, having annual company taxable income taxed at local shareholders rates is always achieved: when annual taxable income is actually distributed, outcomes align with those of imputation design; when taxed income is retained, the outcomes align with dividend reinvestment plans now where the income is still held by the company for investment purposes.

Thus, outcomes under integration align well with those of individual direct investors and trust unitholders/beneficiaries. Under integration, the decision of business owners whether to incorporate would be made for non-tax reasons, rather than tax advantage.

In contrast, the interim report seeks design that encourages retention with the applicable company tax rate applying to company taxable income until it is ultimately distributed.

What integration and the interim report have in common is a path towards reduced company tax rates – though with the interim report having two rates and integration only one.

Against that potted background on integration, Table 3 makes a broad comparison of the interim report's proposals and integration of taxable income. In the background of this comparison are the tax principles of efficiency (or tax neutrality, which often goes hand in hand with fairness) and simplicity.

TABLE 3

Comparison of interim report's proposed redesign and alternative integration of taxable income

Issue	Interim report's corporate NCT plus income taxation	Alternative corporate design: integration of taxable income
Objective	Strong focus on increasing investment	Reduce tax impact across investment decisions

⁴⁴ Mayo (2011), above n 7, pp 212-241 does this for the vanilla situation where companies have only local, ordinary class shareholders.

⁴⁵ Mayo W, 'Time to upgrade Australia's company tax system from imputation to integration', *Australian Tax Forum*, 33 (4), December, pp 753-803, 2018 (Available at: www.kyscope.com.au) and Mayo (2025), above n 7, Chapter 3, Chapter 6 (p 14), does this for the general situation where both non-resident shareholders and multiple classes of shares are involved.

⁴⁶ Mayo (2025), above n 7, Ch3, p 13, 34, Ch6, pp 13-14, Ch8, p 20.

⁴⁷ Mayo (2025), above n 7, Ch8, pp 20-21.

Tax design concept	Lower/higher taxes for smaller/larger, and immediate expensing under the additional NCT for all, companies	Annual taxable company income taxed at the rates of local individual shareholders (even when retained for investment)
Encourage retained income	Yes	Balance between funding sources
Treatment of income across investment modes	Widens the difference between companies and alternative modes	Furthers balance across investment modes ⁴⁸
Design complexity	Draws on unchanged corporate data – but extra deductions to offset the capital levy effect a complication (other issues, too ⁴⁹)	Treatment of multiple share classes, in particular, to be finalised – but current AMIT regime closely aligned
Tax-neutrality features	NCT tax-neutral in isolation – but not when simply added on top of company income tax	Bolsters tax-neutrality of income tax system
Associated simplification of tax code	None	Much scope for shortening and simplification of various parts of the law ⁵⁰
Public's acceptance	Requires clear, informed advocacy with detailed worked examples ⁵¹	Requires clear, informed advocacy with detailed worked examples
Boundary lines	Boundary lines between companies of different sized/profitability. Separate (yet to be determined) treatment of financial services	Furthers individuals' annual taxable income from all sources going into same assessment melting pot in the same year
Effect on bucket companies	Lower tax rates for closely-held companies exacerbates their use	Removes their tax advantage and cost regardless of company tax rate
Tax rates	Lower tax rate for small and medium companies	Potentially lower single rate for all companies

⁴⁸ Further uniformity between investment modes could be achieved with changes to design of discretionary trusts. Those changes would seek to align distributable income and taxable income so that those entitled to trust income were taxed on it. In the process, current enormous complexity associated with the interaction of CGT and discretionary trusts could be addressed (see Mayo (2025), above n 7, Ch6, pp 24-29).

⁴⁹ Like treatment of acquisition costs/receipts. See Mayo (2013) above n 14, p 42-43.

⁵⁰ For example, the bulk of provisions aimed at preventing access to untaxed private company profits (Division 7A) could be abolished because annual taxable income would always be taxed each year. See Mayo (2025), above n 7, Ch7, pp 18, 21, 24-26, Ch8, p 23.

⁵¹ Including examples supporting proposed uplift rate(s).

The interim report raises the prospect of seeking guidance from “Australian tax administration authorities” in the finalising of changes to company tax design. The commission may wish to consider recommending its final proposed redesign, as well as integration of taxable income, be put through Treasury’s integrated tax design process⁵² for comprehensive evaluation.

That would set the scene for ongoing broadening of the system-wide income tax base (with the potential for accompanying tax rate reductions) – in conjunction with simple, consistent, principles-based redesign of the income tax base and its specification of changing tax values across all categories of assets and liabilities.⁵³

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⁵² Integrated tax design, initiated by the Ralph review (above, n 11, pp 95-97), brings together tax policy advisers, administrators and lawyers early in the tax design process.

⁵³ See Mayo (2025), above n 7, Chapter 1.

ATTACHMENT: ECONOMIC DEPRECIATION APPLIED UNDER INTERIM REPORT'S TAX DESIGN AND UNDER TAX-NEUTRAL DESIGN

TABLE A1

Company in interim report's Table B.7 subject to 5% NCT plus income tax with economic depreciation of \$500,000 capital investment

Year	Pre-tax cash flow (a) \$	Income tax depreciation (b) \$	Taxable income (c) \$	Income tax payments at 30% (d) \$	Post-income tax cash flow (e) \$	5% NCT (f) \$	Post-all taxes cash flow (g) \$	Total tax revenue (h) \$
0	-500000				-500000	-25000	-475000	-25000
1	131899	-81899	50000	15000	116899	6595	110304	21595
2	131899	-90089	41810	12543	119356	6595	112761	19138
3	131899	-99098	32801	9840	122059	6595	115464	16435
4	131899	-109008	22891	6867	125032	6595	118437	13462
5	131899	-119908	11991	3597	128302	6595	121707	10192
NPV	Zero (i)			\$34,836(i)	Zero (j)	Zero(i)	-\$1,906(j)	\$34,836(i)
IRR	10.0%				7.00%	10.0%	6.84%	
Sum				\$47,848		\$7,975		\$55,823

(a) As in Table B.7 of interim report.

(b) Economic depreciation of asset valued at \$500,000 Year 0 that produces constant cash flow until total collapse at end Year 5 (a 'one-horse-shay' asset). Value of investment using 10% pa discount rate is got from Year 1 onwards from 10% x prior year value. Annual economic depreciation is then current year less prior year value.

(c) From Year 1, Column (a) less Column (b).

(d) Column (c) x 30% income tax rate.

(e) Column (a) less Column (d).

(f) 5% x Column (a), as in Table B.7 of interim report.

(g) Column (a) less Column (d) and Column (f).

(h) Column (d) plus Column (f), as in Table B.7 of interim report.

(i) Discounting at 10% pa pre-all taxes discount rate.

(j) Discounting at investors' post-income tax discount rate of 7% pa – that is, 10x(1-0.3)% pa.

TABLE A2

Company in interim report's Table B.7 subject to income tax with economic depreciation of \$500,000 investment and taxable income based on cash flow after 5% NCT

Year	Pre-tax cash flow (a) \$	5% NCT refunds /tax paymts (b) \$	Cash flow after NCT (c) \$	Income tax depreciation (d) \$	Taxable income post-NCT (e) \$	Income tax paymts (f) \$	Post-all taxes cash flow (g) \$	Total tax revenue (h) \$
0	-500000	-25000	-475000				-475000	-25000
1	131899	6595	125304	-77804	47500	14250	111054	20845
2	131899	6595	125304	-85584	39720	11916	113388	18511
3	131899	6595	125304	-94143	31161	9348	115956	15943
4	131899	6595	125304	-103557	21747	6524	118780	13119
5	131899	6595	125304	-113913	11391	3417	121887	10012
NPV	Zero (i)	Zero (i)	Zero (i)			\$33,094(i)	Zero (j)	\$33,094(i)
IRR	10.0%	10.0%	10.0%				7.00%	
Sum		\$7,975				\$45,456		\$53,430

(a) As in Table B.7 of interim report.

(b) 5% x Column (a), as in Table B.7 of interim report.

(c) Column (a) less Column (b).

(d) Economic depreciation of asset valued at \$475,000 Year 0 that produces constant cash flow until total collapse at end Year 5 (a 'one-horse-shay' asset). Value of investment using 10% pa discount rate is got from Year 1 onwards from 10% x prior year value. Annual economic depreciation is then current year less prior year value.

(e) From Year 1, Column (c) less Column (d).

(f) Column (e) x 30% income tax rate.

(g) Column (c) less Column (f).

(h) Column (b) plus Column (f).

(i) Discounting at 10% pa pre-all taxes (and post-cash flow tax) discount rate.

(j) Discounting at investors' post-income tax discount rate of 7% pa – that is, 10x(1-0.3)% pa.