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Productivity Commission

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EY Australia Response to the Productivity Commission's Interim Report: Creating a more dynamic and resilient economy

EY recognises that Australia faces a rapidly evolving economic landscape, shaped by population ageing, growing demand for care and support services, ongoing technological and digital transformation, the urgent challenges of climate change and rising geopolitical fragmentation. In such a dynamic environment, it is imperative that policy settings are regularly reviewed and refreshed to ensure Australia is positioning to maximise economic outcomes and living standards for all.

To drive meaningful gains in productivity, it is necessary to focus on amplifying those initiatives and policy levers that deliver the greatest positive impact, while reducing or retiring measures that are less effective or counterproductive. Across our four submissions to the Productivity Commission, EY has aimed to provide practical, market-based insights grounded in our experience supporting both private and public sector organisations to enhance productivity.

We consider that a clear, evidence-based approach—supported by open dialogue and collaboration between government, industry, and the broader community—will be essential to successfully navigate the challenges ahead and to deliver on the vision outlined in the Australian Government's productivity growth agenda. EY welcomes the opportunity to share further details of our analysis and recommendations as required by the Productivity Commission.

Our submissions have been prepared with the assistance of EY AI tools, for example to support research and proofreading.

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CORPORATE TAX REFORM TO SPUR BUSINESS INVESTMENT

EY believes that the proposed net cashflow tax (NCT) will make Australia's already uncompetitive corporate tax system even more uncompetitive potentially stifling domestic business investment and turning mobile capital away.

The proposal is based on a flawed assumption that an increase in effective tax rate to 35% from 30% will result in businesses over $1bn turnover continuing to invest at current levels or increasing their investment in Australia.

Even for small companies, the proposed corporate tax rate of 20% plus a NCT of 5% is uncompetitive internationally, and higher than the OECD average of 21%. The proposal also wrongly assumes that any reduction in investment by large businesses will be more than offset by increased investment by businesses with less than $1bn turnover. A 2021 RBA report[1] suggested that the top 20% of companies represent around 80% of all investment and so drive most of Australia's capital deepening and contribute significantly to productivity gains.

The proposed NCT is an untested "world first". It poses a risk to already weak business investment given the rate of the NCT would increase over time, but with no cap specified. There is further uncertainty due to the exclusion of the financial services sector, which comprises a significant portion of the economy. There are no meaningful reasons for the sector's exclusion, and no indication as to whether an alternative regime would be applied to companies excluded from the NCT.

There are several unintended consequences that should be considered. The proposed NCT is not industry-agnostic and will disproportionately impact industries that are not capital intensive. Service industries, for example, do not continually invest more than they earn. The tax would also give rise to adverse interactions with existing corporate tax regime and the recently introduced global and domestic minimum tax rules.

The proposed NCT would add considerable complexity to the corporate tax system as it would create a dual tax system. Businesses operating in Australia would be subject to various multiple overlapping corporate taxes, resulting in increased compliance costs. A NCT would require businesses to undertake new and separate calculations and require the tracking of all cash outflows and inflows, adding significantly to the compliance burden.

The experience of other countries, such as Mexico, and conclusions drawn in academic papers, illustrate some of the key challenges with the proposed NCT. A European Commission report[2] found that cash flow taxation is overly complex, imposes a significant compliance burden on businesses, and is difficult to administer by revenue authorities. It is also open to manipulation. This would inevitably lead to the introduction of detailed rules and anti-avoidance measures, which would add further complexity for businesses and administrative issues for revenue authorities.

In our view, there are much simpler ways to encourage additional capital expenditure, such as permanent full expensing of capital expenditure (without further modification to tax deductibility including for interest expenses). This could be coupled with targeted tax incentives to boost capital deepening and productivity as we raised in our June 2025 responses to the Productivity Commission's questionnaire and to the Treasury's Economic Reform Roundtable consultation. We have summarised these responses in Appendix A.

Reduced corporate tax rates for certain activities or industries could be introduced in conjunction with full expensing of capital expenditure. A short-to-medium term cost to revenue would be offset by a longer-

[1] Which Firms Drive Business Investment? New Evidence on the Firm-size Distribution | Bulletin – December 2021 | RBA, retrieved on 1 September 2025.
[2] European Commission, Experiences with cash-flow taxation and prospectus final report

term uptick in economic activity and tax receipts. For example, Germany is gradually reducing their corporate tax rate, whilst providing accelerated depreciation for fixed assets.

Action to address tax administration issues and the increasing and significant compliance burden, should also be addressed. This concern was raised in our June 2025 responses to the Productivity Commission's questionnaire. An outline of these tax policy and tax administration issues is set out in Appendix B.

Net Cashflow Tax Issues and Concerns

We are concerned that the proposed NCT:

- Deters business investment by large companies by increasing the headline tax rate to 35% potentially bringing the effective tax rate (ETR) up to 39%
- Results in a headline corporate tax rate of 25% for other businesses which is still higher than the OECD average of 21%
- Does not benefit, and in some cases penalises, businesses currently subject to the base rate entity 25% tax rate
- Does not take into account interest outgoings, effectively resulting in the imposition of a levy of 5% on interest paid, which disproportionately impacts businesses and industries that rely on debt to fund capital investments.
- Penalises businesses that seek to grow revenue beyond $1bn pa
- Potentially disincentivises the development of innovation and intellectual property (IP) assets in-house, by not providing preferential treatment for expenditure on R&D and potentially creating a tax preference to buy innovation and IP assets
- Undermines development and commercialisation of IP in Australia given the NCT of 5% on cash flow from IP commercialisation
- Deter equity investment if NCT payments do not generate franking credits. Dividends representing profits taxed at the 5% NCT rate would be unfranked and taxed again at the Australian investor level and for non-resident investors via withholding tax. This will have a disproportionate impact on owners in base rate entity companies and resident investors (including superannuation funds). It will also negatively impact non-resident investors of non-treaty countries in companies with under $1b turnover and therefore increase the cost of capital.
- Potentially lead to additional tax payments under the Global Minimum Tax Rules if the entity forms part of a Group with a global turnover of more than €750m. This could arise due to the impact of the accounting treatment of the NCT and the likely non-recognition of the NCT as tax paid for the purposes of determining whether the requisite 15% minimum tax has been paid under OECD Rules.

Net Cashflow Tax Design Issues

The NCT proposal is currently incomplete and there are many uncertainties including:

- What capital expenditure is deductible
- Whether intangible assets, such as IP and goodwill, are deductible upon acquisition of a company
- What rules apply in merger and acquisition scenarios, including interaction with tax consolidation rules which 'deem' a 'market value' on the underlying assets of a target company

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- How revenue for determining the rate of corporate tax is determined and interaction with base rate entity rules
- How NCT will interact with double tax treaties and foreign jurisdictions' tax credit rules
- How NCT will treat existing capital expenditure, and whether the NCT will recognise the starting base of capital expenditure to ensure equity so as not to penalise businesses that have already invested
- Whether the NCT will include appropriate grandfathering/ entry rules

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Appendix A

Recommended targeted new tax incentives and enhancement of current incentives

Investment capital (both domestic and international) is mobile and drawn to internationally competitive tax and investment settings. Australia has a high corporate tax rate and has implemented various anti avoidance and base broadening measures and offers little in the way of internationally competitive corporate tax incentives.

Bold policy reforms are needed to position Australia as a premier destination for international business and innovation and to unlock the full potential of our stable political environment, highly educated workforce, and strong research output. Organisations that make large, targeted capital expenditures, and research and development (R&D) investments promote capital deepening and can help lift national productivity growth.

This appendix summaries our key recommendations to help address such issues.

We recommend:

- Targeted, permanent and globally competitive tax incentives for investments in strategic industries, technologies and/or regions.
  - Reduced corporate tax rates for new investment in preferred activities, industries, or regions. Countries such as Singapore and China provide concessional corporate tax rates of between 5% and 15% to encourage business investment and growth in specific industries or activities deemed strategically important
  - Investment allowances or bonus deductions that contribute to preferred capital deepening and national economic resilience. Targeted tax credits of up to 30% are offered by other countries
  - Reduced corporate tax rates for targeted services industries reliant on highly skilled mobile workers rather than physical capital, enabling businesses to grow skilled jobs in Australia, and compete globally. This could involve modernising the now defunct Offshore Banking Unit (OBU) incentive
- Improve Australia's R&D tax incentives ecosystem to be more effective and internationally competitive, including by promoting end-to-end investment in R&D, which stimulates R&D activities and encourages development and commercialisation of the intellectual property (IP) in Australia.
  - Modernise R&D eligibility criteria and remove the notional deductions cap to boost large-scale investment
  - Make all R&D tax offsets refundable, raise the additional offset to at least 10%, and offer a 20% premium for targeted sectors
  - Provide quarterly or semi-annual refundable credits to small businesses with turnover under $20m
- A complimentary new development or innovation incentive to encourage the development and commercialisation of intellectual property in Australia and discourage offshoring of IP ownership.
  - A preferential tax rate or a concessional tax deduction on qualifying IP income. This could be delivered in a more narrowly focussed patent box regime.

Appendix B

Tax policy and tax administration issues that discourage business investment

Stable and predictable tax settings are essential to encourage investment and risk taking.

This appendix outlines corporate tax policy and administration issues identified by EY that have been found to restrain or discourage investment in Australia.

- The evolution of the Australian tax system has favoured an anti-avoidance rather than a pro-investment approach. It is characterised by novel, pro-revenue interpretations, inconsistent with international norms and tax law, with retroactive effect and/or impact. This can result in significant compliance costs to merely confirm long standing tax treatments.
- Businesses face significant tax compliance costs due to overlapping data filing requirements, numerous complex anti-avoidance and base broadening measures, and tax law with retroactive effect. Simplifying and streamlining tax reporting obligations and overlapping tax rules will ease the compliance burden on businesses.
- Much of the compliance cost relates to compiling and providing significant volumes of data to the Australian Taxation Office (ATO) which does not result in additional revenue to government. Subsequent ATO information requests are often duplicative and unnecessarily burdensome. ATO reviews routinely exceed the statutory review period as the ATO insist on extensions of time to complete the reviews, resulting in further compliance costs and continuing uncertainty.
- Businesses are required to create substantial non-standard business records or find such records from many years ago. For example, the recently enacted debt deduction creation rules, require documentation to demonstrate how funds were used years and even decades before the commencement date of the rules. Where such records are not available, there is a cost to business from denial of tax deductions.
- Lack of consultation at the policy development stage of new law (i.e. before announcement of policy to be enacted). This contributes to poorly targeted law changes notwithstanding subsequent consultation.
- Legislation by government announcement. tax announcements often take years to become law, yet are treated as operative immediately, creating uncertainty and delaying investment. Limited early-stage consultation leads to unclear legislation. Leaving interpretation to the ATO can diverge from intended policy and undermine investor confidence.
- Continued tinkering with the corporate tax rules including the introduction of numerous complex and overlapping anti-avoidance and base broadening measures undermines the stability and predictability of the Australian tax system. For businesses, substantial expenditure on systems, people and processes is required to comply.
- Businesses find it difficult to comply with various new corporate tax rules, especially when they apply retrospectively. New measures should apply prospectively and be implemented with transitional rules to ease the compliance burden.