SUBMISSION TO THE BUSINESS TAX WORKING GROUP

Cutting the company tax rate and broadening the base discussion paper

September 2012

BusinessSA
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Business SA (the trading name of the South Australian Employers' Chamber of Commerce & Industry) is the State's leading business organisation, representing thousands of businesses through direct membership and affiliated industry associations.

We represent businesses across all industry sectors ranging in size from micro-business to multi-national companies. Business SA is the voice of business in South Australia and advocates on behalf of business to propose legislative reforms for a sustainable economic growth in the State.

We deliver a wide range of integrated services to business, including:

– lobbying and representation
– workplace relations advice
– consultancy services
– wide-ranging training programs
– reference publications and handbooks
– international trade services
– management of apprenticeships and traineeships.

As the peak employer organisation in South Australia, Business SA is well placed in representing the interests of members across most industries in South Australia.

Taxation is a major issue for the business community and Business SA is pleased to make a submission to the Business Tax Working Group (BTWG) on the Discussion Paper.

Business SA is a member of the Australian Chamber of Commerce and Industry (ACCI) and this submission should be read in conjunction with ACCI's submission.

Overarching comments

Business SA supports a cut in the company tax rate. A reduction in the rate of company tax would be expected to make Australia more internationally competitive and encourage investment (including foreign investment), innovation and employment. Higher levels of productivity and improved living standards would result. The greater the cut, the greater these effects would be.

However, it is important to note that a cut to the company tax rate will not benefit businesses that are not incorporated, which is a significant proportion of the small business sector. The positive effects outlined above will be diluted as a result.

Business SA supports the view of the Australian Chamber of Commerce and Industry that the cut to the company tax rate should be funded through cuts to Government expenditure, rather than removing beneficial tax concessions and incentives from the business tax system. An independent and thorough, “root and branch”, review of Government expenditures should be undertaken, to identify and reduce inefficiencies and wastage and reduce expenditure accordingly..

Only a few of the options proposed in the Discussion Paper to broaden the business tax base are considered by Business SA to be acceptable. Those involving interest deductibility and thin capitalisation for business tax payers have the greatest merit.

Furthermore, many of the options canvassed in the Discussion Paper are likely to pit industry against industry in subsequent discussions and lobbying efforts. Indeed, Business SA believes that the BTWG has been established by the Commonwealth Government to ensure that the business community does not have a united voice in lobbying for a cut in the company tax rate. This has been done for political purposes and is in no way the fault of the BTWG itself.

Certainly Business SA acknowledges and appreciates the substantial work of the BTWG to identify and analyse a wide array of options to broaden the company tax base.

Business SA supports the BTWG’s view that an allowance for corporate equity should not be considered in the short to medium term. This would require significant changes to the business tax system, which could result in a higher company tax rate and the removal of some tax concessions.

Cutting the company tax rate

Business SA supports a cut in the company tax rate. Australia has one of the highest company tax rates in the OECD at 30 per cent. This is lower than the United States and Japan at 40 per cent and Belgium and France at 35 per cent. The rate is above the OECD unweighted average of 25.5 per cent, but below the weighted average of 32.9 per cent (which reflects the size of the economies of the United States and Japan). The company tax rate in Australia is also above the average of 23 per cent of Australia's Asian neighbours.

A reduction in the rate of company tax would be expected to make Australia more internationally competitive and encourage investment (including foreign investment), innovation and employment. The greater the cut, the greater these effects would be.

Business SA and the Australian Chamber of Commerce and Industry surveyed members in the first half of 2010, in the lead up to the 2102 Federal Election, to gather business views on a wide range of issues, including taxation. Company tax reform was highlighted as the second highest priority in terms of taxation reform, behind personal income tax reform.

In the June 2012 edition of the *Business SA Survey of Business Expectations*, respondents were asked what the impact of the Commonwealth Government's decision to renege on the company tax cut would be on their investment plans. Half of the respondents indicated that it would have a significantly negative impact (21 per cent) or a moderately negative impact (29 per cent). Almost 49 per cent claimed it would have no impact, with the remaining 1-2 per cent saying the impact would be positive.

It is likely that many of the businesses that responded that there would be no impact are not incorporated.

Indeed, it is important to note that a cut to the company tax rate will not benefit businesses that are not incorporated, which is a significant proportion of the small business sector. The positive effects outlined above will be diluted as a result.

A cut to the company tax rate will also increase the gap between the company tax rate and the higher personal income marginal tax rates, exacerbating the distortions that currently exist in tax-related decision making associated with business structures and avoidance.

Business SA was disappointed that:

– the Government's response to the Henry Tax Review recommendation of a cut to the company tax rate from 30 per cent to 25 per cent was a muted cut of just two per cent

– the two per cent reduction in the company tax rate was subsequently limited further to a one per cent cut

– the one per cent cut to the company tax rate was withdrawn in the Federal Budget

– the subsequent promise to cut the company tax rate was linked to a requirement that the cut had to be funded from changes within the business tax system, even though it had originally said it would be funded in the Mineral Resource Rent Tax package.

This series of events has created considerable uncertainty in the business community and there is scepticism about the delivery of a cut in the company tax in the short to medium term.

Furthermore, the Commonwealth Government's approach to raising taxes and charges on the business community, through the Mineral Resource Rent Tax, the carbon pricing mechanism and the rise in the Superannuation Guarantee Levy, is a major concern. It will have a negative impact on the country's productivity, competitiveness, ability to attract investment, grow jobs and generate higher levels of income and an improving standard of living for all Australians.

Broadening the company tax base

While Business SA is disappointed with the restrictive terms of reference that the BTWG was given with regards to limiting the way to fund a company tax cut, Business SA acknowledges and appreciates the substantial work of the BTWG to identify and analyse a wide array of options to broaden the base of the business tax system.

Business SA supports the view of the Australian Chamber of Commerce and Industry that the cut to the company tax rate should be funded through cuts to Government expenditure, rather than removing beneficial tax concessions and incentives from the business tax system. An independent and thorough, “root and branch”, review of Government expenditures should be undertaken, to identify and reduce inefficiencies and wastage.

At some point, hopefully not too far into the future, all political parties will acknowledge the necessity for increasing the rate and/or broadening the base of the GST. This will be required to fund the higher expenditures and lower revenues associated with an ageing population and reduced workforce participation. Raising the revenue gained from the GST should also drive broader taxation reform that would include abolishing inefficient State taxes as well as personal income tax rates, which will help many small business owners.

Many of the concessions and incentives identified and analysed in the Discussion Paper provide important benefits to businesses. To broaden the business tax base to fund a cut in the company tax rate by reducing or removing these will have negative impacts for some businesses.

Business SA supports the BTWG’s view that the net effects of reducing the company tax rate and broadening the base need to be examined carefully. This examination needs to occur at a number of different levels – economy-wide, by sector or industry and on decision making, such as investment, research and development, as well as employment.

Some businesses will be better off from a change to a lower company tax rate and a broader base, while others will be worse off, particularly those that benefit from the existing array of concessions or incentives. It needs to be demonstrated that there would be an overall benefit to the economy before such a change occurs.

Interest deductibility and thin capitalisation

Options A.1 to A.3

Given that it is not used, Business SA supports removing the arm’s length minimum capital amount test for banks.

Business SA believes that more work needs to be done before reaching a position on reducing safe harbour gearing levels for general entities. However, measures that place multinational businesses and Australian businesses on an equal footing are supported in principle.

Given that Option A.3 – reducing safe harbours for financial institutions – reflects changes in the minimum capital requirements in the regulatory banking environment, which is supported.

Options A.4 and A.5

Business SA believes that more work needs to be done before reaching a position on capping interest deductions, including for banks. However, measures that place debt and equity as a means of raising finance for businesses on a more equal footing are supported in principle.

Capital allowances and the treatment of capital expenditure

Option B.1

Business SA does not support reducing the diminishing value rate for depreciation from 200 per cent to 150 per cent. The rate was increased in 2006-07 and reversing this change has no economic rationale. Reducing the rate would have a negative impact on investment, some of which is being undertaken to help businesses to adjust to the multi-speed economy.

Options B.2 to B.5

Business SA understands the attractiveness and economic rationale of depreciating assets in line with their effective lives and removing differential treatment for some assets would place all asset investments on an equal footing.

However, many of the assets subject to statutory effective life caps are major inputs for a number of important sectors, such as agriculture and oil and gas, which are often impacted by considerable cyclical and/or seasonal variations. These variations create uncertainty which is likely to raise the rate of return required before an investment is undertaken. The application of effective life caps enables businesses investing in these assets to benefit from improved cash flow at what could be times of financial stress and makes such investments more likely to occur.

Removing the effective life caps for these assets would lead to lower investment and may make structural adjustment in agricultural industries more difficult. Business SA does not support these options.

That said, one change that could be considered would be to remove the capped effective life provided to infrastructure that is subject to decisions by the Australian Energy Regulator, namely some gas transmission and distribution assets. This is because a regulated rate of return is provided to gas businesses and removing the effective life cap should not impact on investment. However, such a change would be unlikely to yield much revenue for the Commonwealth Government.

Options B.7 to B.11

An important argument for retaining immediate deductibility for exploration and prospecting expenditure is that such expenditure has public good elements, similar to research and development. The information obtained from such expenditure, whether it reveals a potential ore body or not, can be used by other businesses if the business undertaking the exploration does not proceed with a mine development. Furthermore, such expenditure is no guarantee of success and substantial exploration and prospecting expenditure may be required before a business can develop a mine and earn revenue.

Indeed, these are among the reasons the South Australian Government has implemented the very successful Plan for Accelerating Exploration (PACE), which has provided important geological data for businesses to speed up exploration and increase the likelihood of mineral development.

Furthermore, reducing incentives for exploration would slow down one of the few parts of the economy that is thriving and Business SA strongly believes that immediate deductibility for exploration and prospecting expenditure should be retained.

Options B.12 to B.14

Business SA considers that changing building depreciation arrangements during the current slowdown in the building construction industry would not be appropriate. Changes may create uncertainty and further damage the already weak confidence in the industry, leading to lower levels of investment than currently exist.

The diminishing value method of determining depreciation is also not particularly relevant for buildings, as alluded to in the Discussion Paper.

Furthermore, the options proposed in the Discussion Paper would not provide a significant increase in revenue and if implemented may lead to a loss in economic value that is greater than the revenue savings.

Research and development tax incentive

The current Research and Development (R&D) Tax Incentive has only been in place for a little over twelve months. While some aspects of the initiative were not fully supported by the business community, it is important that the current arrangements are given enough time to be tested and proven effective or otherwise, before further changes are made to the R&D support system in Australia.

Further changes will only create more confusion and uncertainty, which would likely result in reduced investment in R&D.

Therefore Business SA does not support changing the R&D Tax Incentive at this time and in particular reducing the benefits that it provides to innovative businesses.

Another option

One option for at least partially funding a cut to the company tax rate that has yet to be considered is the money being used to save jobs and to prop up individual businesses in industries that may not have a long term future in Australia, unless they and the businesses within them reinvent themselves appropriately.

Business SA believes that taxpayers' money that is being used for co-investment in new or upgraded facilities, production processes or research and development, or money that is being used to train displaced workers, is a valid use of funds.

However, taxpayers money that is being provided to individual businesses to keep them in operation over the short to medium term, without any plan to improve efficiency, innovate or cut costs to ensure their long term viability, is not a valid use of funds. This money would be better spent on a reduction in the company tax rate that benefits all incorporated businesses.

Allowance for corporate equity

Business SA supports the BTWG’s view that an allowance for corporate equity should not be considered in the short to medium term. This would require significant changes to the business tax system, which could result in a higher company tax rate and the removal of some tax concessions.

A substantial review would be required to consider an allowance for corporate equity and would need to include appropriate consultation with all stakeholders.

Conclusion

Business SA supports a cut in the company tax rate. A reduction in the rate of company tax would be expected to make Australia more internationally competitive and encourage investment (including foreign investment), innovation and employment. The greater the cut, the greater these effects would be.

However, it is important to note that a cut to the company tax rate will not benefit businesses that are not incorporated, which is a significant proportion of the small business sector. The positive effects outlined above will be diluted as a result.

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