4

Taxation policies

4.1 Taxation is a key factor influencing business investment in Australia. The need for stable and transparent taxation policies that are internationally competitive and do not place an unfair burden on businesses, were key messages during the inquiry.

4.2 The Department of Foreign Affairs and Trade (DFAT) and the Australian Trade and Investment Commission (Austrade) commented that taxes 'affect investment in fixed (including intangible) capital, innovation, allocative efficiency, entrepreneurship, labour productivity and exposure to trade and Foreign Direct Investment.'[1]

4.3 The committee heard that complex, onerous and uncompetitive tax measures can hinder domestic business investment and discourage foreign investment in Australia. However, groups acknowledged that while a factor, tax is not the only consideration when it comes to attracting investment to Australia.

4.4 Austrade observed that foreign investors valued 'certainty, transparency, predictability of policy, and regulation that is harmonised.'[2] It stated that:

> I do know from talking to investors that they do look at tax as an input into their financial modelling. They do look at after-tax returns; that's a very important part. And just like energy costs or labour costs, it can go up or down, depending on how that is. So,

1 Department of Foreign Affairs and Trade (DFAT) and Australian Trade and Investment Commission (Austrade), *Submission 19*, p. 7.

2 Mr Graham Putt, General Manager, Trade and Investment, Austrade, *Committee Hansard*, 7 August 2018, p. 16.

> looking at an after-tax return is a very important element of any investor.[3]

4.5 Further, Austrade outlined that in addition to tax, foreign investors will also consider the following elements when making their investment decision:

- Australia's strong legal framework
- Australia's years of continuous economic growth
- availability of skilled labour
- competitiveness of the relevant industry, including export and local market opportunities
- Australia's proximity to Asia, and
- Australia's high-quality assets.

4.6 Tax measures encouraging innovation are detailed in Chapter 3 on innovation.

International competitiveness

4.7 A number of groups stressed the importance of Australia remaining competitive in order to attract capital investment.

Company tax rates

4.8 On 11 May 2017, the Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 was introduced to the House of Representatives. It proposed to progressively extend the lower corporate tax rate to all corporate tax entities, and further reduce the corporate tax rate to 25 per cent by 2026–27. On 21 August 2018, the Australian Government announced it will not be proceeding with the Bill.[4]

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3 Mr Graham Putt, General Manager, Trade and Investment, Austrade, *Committee Hansard*, 7 August 2018, p. 16.

4 Australian Tax Office (ATO), *Reducing the corporate tax rate*, 31 October 2018, <https://www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-businesses/Reducing-the-corporate-tax-rate/>, accessed 5 November 2018.

4.9 Australia has a two-tiered system for company taxes: the full company tax rate of 30 per cent; and, from 2017-18, a lower company tax rate of 27.5 per cent for companies (base rate entities) with an aggregated annual turnover below a certain level.

4.10 A base rate entity is a company that:

- has an aggregated turnover less than the aggregated turnover threshold ($25 million for the 2017–18 income year and $50 million from 2018-19), and
- 80 per cent or less of their assessable income is base rate entity passive income (for example, corporate distributions, royalties and rent, interest income, and a net capital gain). This replaces the requirement to be carrying on a business.[5]

4.11 Evidence to the inquiry stressed that Australia's company tax rates are too high in contrast to comparable nations. A range of groups argued that this puts Australia at a disadvantage when it comes to attracting business investment.

4.12 The Australian Retailers Association (ARA) argued that Australia's relatively high company tax rates 'discourage investment and stifle competition, especially with overseas businesses who enjoy better trading conditions.'[6]

4.13 DFAT and Austrade noted that Australia's company tax rates are now 'significantly above the average rate of other countries, particularly our Asian neighbours, with who we compete for foreign investments.'[7] However, Austrade also observed that 'the feedback we received from investors is that a lower tax rate is always welcome, but that is only part of an investment decision.'[8]

4.14 The ARA described Australia as 'an overly complex, high-taxing economy'.[9] It cautioned that with 'recent moves by several of Australia's G20 counterparts to reduce corporate tax rates by 2020' Australia will be left 'further behind the world's advanced economies.'[10] The ARA stated

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5 ATO, *Changes to company tax rates*, < https://www.ato.gov.au/Rates/Changes-to-company-tax-rates/?page=1#Base_rate_entity_company_tax_rate>, accessed 14 December 2018.

6 Australian Retailers Association (ARA), *Submission 15*, p. 18.

7 DFAT and Austrade, *Submission 19*, p. 8.

8 Ms Margaret Bowen, Assistant General Manager, Ministerial, Economic and International Engagement, Austrade, *Committee Hansard*, 7 August 2018, p. 17.

9 ARA, *Submission 15*, p. 21.

10 ARA, *Submission 15*, p. 18.

that if the company tax rate is not reduced then there will be 'whole swag of companies that are going overseas.'[11]

4.15 The Minerals Council of Australia (MCA) noted that it had commissioned a study into Australia's investment challenges arising from the 2018 tax reforms in the United States. The study found that 'by 2020 Australia is set to have the second highest company tax rate in the Organisation of Economic Co-operation and Development (OECD).'[12]

4.16 The committee heard that Australia's company tax rates makes it less competitive, particularly when compared to peer nations like the United Kingdom and the United States, and geographical neighbours like Singapore.[13]

4.17 When questioned by the committee on how Australia's company tax rates compare with its Asian neighbours, DFAT advised that the tax rates are: China 25 per cent; Singapore 17 per cent; Malaysia 24 per cent; Japan 30.62 per cent (reduced from 30.86 per cent); and Thailand 20 per cent.[14]

4.18 KPMG supported company tax reductions and stressed that governments need to take a long-term view when considering company tax settings. It noted that the benefits were not instant, but occurred over a long period of time.

4.19 CSL and Cochlear described the international competition for capital investment as 'fierce'. They cautioned that Australia, with its 'overall corporate tax rate of 30 per cent and zero differential or boutique offerings in exchange for investments and jobs is becoming increasingly isolated as a high-tax jurisdiction uncompetitive internationally'.[15] They stated:

> An overall reduction in corporate tax rates is now standard practice internationally. From 2017, the UK corporate tax rate is 19% (reducing to 17% in 2020), from 2020, the French corporate tax rate is 28% (reducing to 25% in 2022), and from 2018 the US Federal tax rate is 21%.[16]

11 Mr Russell Zimmerman, Executive Director, ARA, *Committee Hansard*, 1 August 2018, p. 21.

12 Minerals Council of Australia (MCA), *Submission 17*, p. 14.

13 CSL and Cochlear, *Submission 13*, p. 17.

14 DFAT and Austrade, *Submission 19.1*, p. 5.

15 CSL and Cochlear, *Submission 13*, p. 17.

16 CSL and Cochlear, *Submission 13*, p. 17.

4.20 Cochlear acknowledged that tax was 'just one of a dozen factors' that investors take into account when considering an investment opportunity. However, it noted that tax does impact on the 'overall net present value of the total investments.'[17] Cochlear commented that:

> Interestingly, last week—we're looking at a small investment at the moment in Europe and Israel, and they were out here. One of them commented at the time: 'Gee, I didn't realise that tax was so high in Australia.' That was just off the cuff, but there are lots of discussions around that at the moment in Australia.[18]

4.21 The MCA argued that 'Australian businesses need a lower corporate tax rate to increase investment, jobs and wages.'[19] It also noted that for the mining sector, royalties, while not technically a tax, also had to be paid to the state governments. The MCA claimed that added to the company tax, the two put the effective tax for mining investment in Australia 'somewhere in the 40s—close to 50 per cent'.[20]

4.22 The MCA concluded that irrespective of the type of tax, it is important that the rate is internationally competitive.

4.23 Similarly, the Business Council of Australia stated that 'reducing the company tax rate for larger businesses is becoming more urgent by the day.'[21] It asserted that even a reduction to 25 per cent by 2026-27 will 'barely keep Australia in the game.'[22] It noted that 25 per cent would still be above the OECD average of 24 per cent and the Asian average of 21 per cent.

4.24 The Institute of Public Affairs contended that Australia's tax system discourages investment and job creation, and called for the corporate tax rate to be reduced to at least 25 per cent, but 'ideally to 10 per cent.'[23]

4.25 It is important to note that the headline (basic) company tax rate and the effective tax rate (the average rate at which a company's pre-tax profits are taxed) may differ. While a business may fall under a certain rate, other tax measures and arrangements will affect how much tax the business effectively pays.

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17 Mr Brent Cubis, Chief Financial Officer, Cochlear, *Committee Hansard*, 1 August 2018, p. 27.
18 Mr Brent Cubis, Chief Financial Officer, Cochlear, *Committee Hansard*, 1 August 2018, p. 27.
19 MCA, *Submission 17*, p. 15.
20 Mr James Sorahan, Director, Taxation, MCA, *Committee Hansard*, 1 August 2018, p. 36.
21 Business Council of Australia, *Submission 29*, p. 6.
22 Business Council of Australia, *Submission 29*, p. 6.
23 Institute of Public Affairs, *Submission 34*, p. 4.

4.26 The Institute of Public Affairs observed that even when taking effective company tax calculations into consideration, Australia still compares unfavourably with other developed countries. It stated:

> In terms of the effective corporate tax…there is actually a straightforward study by PricewaterhouseCoopers that finds our effective rate is 26 per cent compared to a global average of 16.3 per cent. …we have the third-highest corporate tax-to-GDP ratio and one of the highest statutory corporate tax rates. The point is that we put all these different measures forward because the reality is that no matter which way we look at our corporate tax rate it's one of the highest in the developed world.[24]

4.27 KMPG also acknowledged the importance of the effective tax rate. It stated that when looking at where Australia sits globally:

> There was a publication produced in the US by the Tax Foundation called the *International tax competitiveness index*, and overall that places Australia, out of 35 Countries, at seventh place in its total tax system. When it looks at company tax systems…our standing falls from seventh to 25th out of the 35 countries. So, overall, there is a view presented by the Tax Foundation that our tax system in general is relatively well-placed, but we are towards the lower end from a corporate tax competiveness perspective.[25]

4.28 The Tax Institute called for moving to a unified 25 per cent company tax rate as quickly as possible because comparable rates overseas are lower. It also commented that the two-tiered company tax rate system has 'added unnecessary complications to Australia's corporate tax rate system'.[26]

4.29 The Tax Institute recognised that while important, the company tax cut is not 'a fix for everyone and for all our problems', and that it is part of a 'much broader jigsaw puzzle that needs to be considered in totality.'[27]

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24 Mr Daniel Wild, Research Fellow, Institute of Public Affairs, *Committee Hansard*, 1 August 2018, p. 46.

25 Mr Brendan Rynne, Partner, Economics and Tax Centre, KPMG, *Committee Hansard*, 31 July 2018, p. 3.

26 The Tax Institute, *Submission 23*, Attachment 1 – '2018-19 Federal Budget Submission', p. 7.

27 Professor Robert Deutsch, Senior Tax Counsel, the Tax Institute, *Committee Hansard*, 31 July 2018, p. 49.

Reducing the tax burden for small businesses

4.30 On 19 May 2017, the Australian Government reduced the company tax rate for businesses with a turnover of less than $25 million for the 2017–18 income year and less than $50 million for the 2018–19 income year.[28]

4.31 The *Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Act 2018* provides that only corporate entities that meet the aggregated turnover threshold and have no more than 80 per cent base rate entity passive income are eligible for the lower corporate tax rate. The date of effect is from the 2017–18 income year.

4.32 The *Treasury Laws Amendment (Lower Taxes for Small and Medium Businesses) Act 2018* accelerated the future reductions in the corporate tax rate for base rate entities as follows:

- 27.5 per cent for the 2019–20 income year (as previously legislated)
- 26 per cent for the 2020–21 income year
- 25 per cent for the 2021–22 income year and for subsequent income years.

4.33 To further assist small businesses, the Australian Government has also announced the creation of a Small Business Concierge Service within the Australian Small Business and Family Enterprise Ombudsman's office (ASBFEO) and a dedicated Small Business Taxation Division within the Administrative Appeals Tribunal to help small business more efficiently resolve tax disputes with the Australian Taxation Office.

Instant asset write-off

4.34 The instant asset write-off involves simplified depreciation rules that enable business to write-off assets in the year they are bought and used, or installed ready for use. The current threshold for an instant asset write-off is $20,000—a marked difference from the $1,000 and $6,500 limits prior to May 2015. The business must have a turnover of less than $10 million and the entire cost of the asset must be less than the $20,000 threshold.

4.35 Assets valued over $20,000 are not eligible for the instant write-off and will be deducted over time.

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28 Australian Tax Office (ATO), *Reducing the corporate tax rate*, 31 October 2018, <https://www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-businesses/Reducing-the-corporate-tax-rate/>, accessed 5 November 2018.

4.36 In the 2015-16 Budget, the Australian Government announced that it would increase the small business immediate deductibility threshold from $1,000 to $20,000 from 12 May 2015 until 30 June 2017.[29] At that time, small businesses were defined as having an aggregate annual turnover of less than $2 million.

4.37 The $20,000 threshold has since been extended twice. In the 2017-18 Budget the Treasurer announced that the measure would be extended by 12 months to 30 June 2018. It then applied to businesses with aggregated annual turnover of less than $10 million.

4.38 In September 2018, the Australian Government extended the $20,000 instant asset write-off for a further 12 months to 30 June 2019. This will enable 3.3 million small businesses with an annual turnover of less than $10 million to access the write-off, providing those businesses with the opportunity to reinvest in their business and replace or upgrade their assets.[30]

4.39 Unless further extended, the instant asset write-off threshold for SMEs will return to $1,000 on 1 July 2019.

4.40 The ASBFEO indicated that it would like to see the instant asset write-off as a long-term policy. It outlined that small businesses had reported that the $20,000 instant asset write-off is 'of particular importance to their ability to continue investing in their business.'[31]

4.41 Further, the ASBFEO recommended increasing the threshold to $100,000 every three years, to encourage new business investment. It stated:

> A decision of putting it in again next budget doesn't give small business the opportunity to plan for a future investment. We'd like to suggest that with small business, could that amount be put up to say $100,000, because the issue of major capital purchases in small business is not just the capital purchase itself; it's the whole red tape issue of depreciation and all the sorts of things that go with that. With a small business it's not like they've got a lot of money floating around in the bank. For them to make a major investment into capital to grow their business, they need to plan

29 The *Tax Laws Amendment (Small Business Measures No. 2) Act 2015* gave effect to the change.

30 The Treasurer, the Hon Josh Frydenberg MP, '$20,000 instant asset write-off extension passes Parliament', *Media Release 006-2018*, 12 September 2018, <http://jaf.ministers.treasury.gov.au/media-release/006-2018/>, accessed 8 October 2018.

31 ASBFEO, *Submission 30*, p. 2.

> for that. To be able to write it off immediately would be a huge benefit.[32]

4.42 While acknowledging that an unlimited amount would be unworkable, the ASBFEO pointed out that currently a business can write-off multiple lots of $20,000 assets, but that 'the moment you need a new ute or tractor or some machinery for your factory that is over $20,000, you're out of the game.'[33]

4.43 The NSW Business Chamber noted that the measure has been a 'very big positive for business' and supported having the instant asset write-off implemented as a standing item in the tax code.[34]

Conclusions and recommendations

4.44 The committee notes evidence to the inquiry that tax is a factor that investors consider when deciding whether to invest in Australia. There are other considerations that positions Australia well for attracting foreign investment, including: Australia's strong legal framework, continuous economic growth; high quality assets; availability of skilled labour; and proximity to Asia and relevant export and import markets.

4.45 However, since tax does—to varying degrees—influences domestic and international business investment decisions, it is important, wherever possible, for the Australian Government to ensure that its taxation policies support rather than hinder business investment.

4.46 Providing greater certainty in its tax policies and harmonising tax arrangements, where there is overlap between Commonwealth and state and territory taxes, must form part of the Australian Government's policy objectives.

Reducing the company tax rate

4.47 As a small, open economy that it a net importer of capital, it is imperative that Australia's company tax rate remains competitive to ensure the economy continues to grow.

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32 Ms Kate Carnell AO, Ombudsman, ASBFEO, *Committee Hansard*, 7 August 2018, p. 2.

33 Ms Kate Carnell AO, Ombudsman, ASBFEO, *Committee Hansard*, 7 August 2018, p. 2.

34 Mr Luke Aitken, Senior Manager, Policy, New South Wales Business Chamber, *Committee Hansard*, 31 July 2018, p. 36.

4.48 Australian businesses carry a heavier tax burden than many of its overseas competitors, which can discourage investment and the creation of jobs. In particular, Australia's relatively high company tax rate increases the rate of return required to make a business or new project commercially viable.

4.49 The committee takes the view that Australia's company income tax rate should be reduced to encourage business investment in Australia, particularly from highly mobile foreign direct investment. This will strengthen Australia's economic growth in the long-term, securing more jobs and providing stronger government revenues.

4.50 Reducing company tax rates for all businesses in Australia to 25 per cent by 2026-27 should continue to be a key priority for the Australian Government.

Recommendation 8

4.51 **The committee recommends that the Australian Government reduce the company tax rate in Australia to 25 per cent for all companies by 2026-27.**

Extending the instant asset write-off for SMEs

4.52 Since May 2015, the Australian Government has increased the threshold for instant asset write-offs from $1,000 to $20,000. This currently applies to businesses with aggregated annual turnover of less than $10 million.

4.53 The committee notes that this has been beneficial for small and medium enterprises (SMEs). This tax measure has provided SMEs with an opportunity to reinvest in their businesses, helping with vital cash flow and enabling them to replace or upgrade their assets. The committee also notes stakeholder concerns that unless extended again, the threshold will revert back to $1,000 on 1 July 2019.

4.54 Currently, individual assets valued over $20,000 are not eligible for the instant write-off and are deducted over time. However, multiple claims for assets under $20,000 are permitted. The committee notes evidence received that this restricts SMEs from making significant asset purchases that exceed $20,000, for example, new vehicle purchases, or agricultural and manufacturing equipment.

4.55 Providing businesses with greater certainty that a higher instant asset write-off threshold will be in place will enable SMEs to better plan for investment, innovation and growth.

Recommendation 9

4.56 **The committee recommends that the Australian Government set the instant asset write-off threshold at $25,000 for small and medium enterprises on an ongoing basis.**

Tax incentives encouraging innovation

4.57 Providing tax incentives for business is one of the key ways in which governments are encouraging businesses to innovate and grow.

4.58 The committee notes that measures like the Research and Development (R&D) Tax Incentive encourages companies to engage in R&D by providing tax offsets for eligible activities, and the early-stage investor tax offset encourages angel and high-net-worth investors to take on more risk and invest in early-stage companies.

4.59 Various National Innovation and Science Agenda initiatives are also valuable in supporting Australian businesses to better translate skills and innovative ideas into commercially viable products and services. The committee notes that government and private sector co-investment has also been a significant driver for business innovation.