

Chris Murphy Econtech

Submission No. 35

INQUIRY INTO BUSINESS TAX REFORM

Senate Finance and Public
Administration References Committee —
Inquiry into Business Tax Reform

*Chris Murphy, Director, Econtech
12 November 1999*

Outline

- Industry Effects of Tax Reform
- General Effects of RBT
- Comments on RBT Measures

Industry Effects: Two Tax Changes

- **ANTS**
 - as passed by Parliament in June 1999
 - indirect tax cuts cost \$24bn
- **RBT business tax measures**
 - from "A Tax System Redesigned"
 - cut in company tax rate to 30% costs \$3bn

Industry Effects: Tax Reform

- **RBT is small change compared with ANTS**
 - \$3bn versus \$24bn
- **don't look at industry effects of RBT in isolation - need to take into account ANTS**
 - Econtech study for ABA
 - Treasurer
 - Shadow Treasurer
 - John Ralph

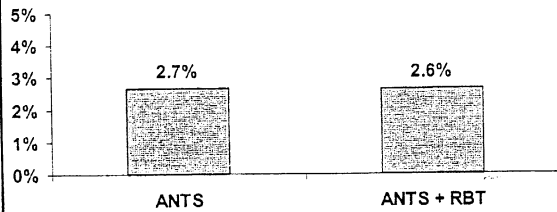
Industry Effects: Econtech Modelling

- **Report for the Australian Bankers' Assoc.**
 - Using Ralph Discussion Paper
- **Report for the Commonwealth Government**
 - Using RBT recommendations
 - Results in Section 25 of RBT Report
- **Today's modelling (from KPMG breakfast)**
 - includes Government's response

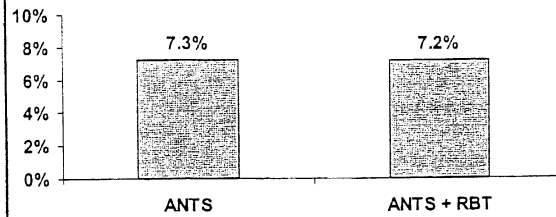
Industry Effects: Growth Dividend

- **RBT modelling assumes no growth dividend**
- **In reality, dividend expected (more later)**

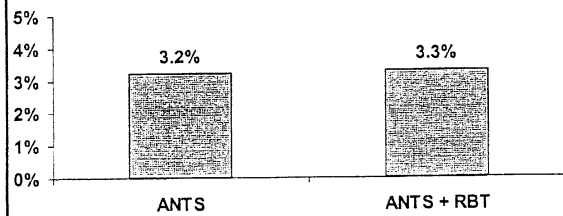
Industry Effects: Agriculture Production



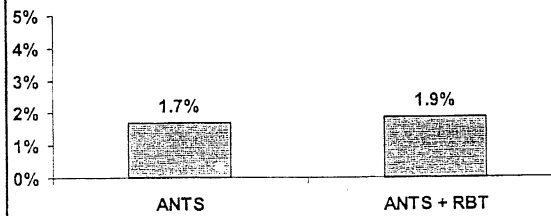
Industry Effects: Mining Production



Industry Effects: Manufacturing Production



Industry Effects: Finance and Insurance Production



Outline

- Industry Effects of Tax Reform
- General Effects of RBT
- Comments on RBT Measures

General Effects: Economic Gain & Modelling Scope

- internationally competitive company tax rate – modelled
- more neutral depreciation allowances – modelled
- remainder of RBT – not modelled

General Effects: Model Inputs

	No RBT 36%	RBT 30%
company rate		
tax lives (years):		
- road vehicles	6.7	6.8
- other t'port equipment	6.1	9.2
- computers	4.0	5.0
- electronic equipment	6.5	10.6
- industrial machinery	6.3	9.7
- other equipment	5.1	7.7
- buildings	40	40

General Effects: Elasticities of substitution

- labour and capital — 0.75
- seven types of capital — 0.5

General Effects: Modelling assumptions

- after-tax rate of return on capital determined in world capital markets
- Australian-owned capital fixed
- profit maximisation
- constant returns to scale

General Effects: Model logic

- lower company tax rate (36% to 30%) ->
- world accepts lower pre-tax rate of return on Australian investments
 - Only partially offset in cost of capital by abolition of accelerated depreciation
- capital stock up (+4.6%)
- GDP up (+1.5%)
- consumption up (+0.4% or \$1.7bn/year)

General Effects: Sensitivity of consumption gain

- labour-capital substitution (0.5/0.75/1.0):
 - \$1.15bn \$1.67bn \$2.17bn
- types of capital substitution (0.25/0.5/0.75):
 - \$1.58bn \$1.67bn \$1.75bn
- annual gain is \$1-2bn
 - large gain for a \$3bn tax reform package

General Effects: Interpretation

- internationally uncompetitive company tax rate highly damaging way to raise revenue
- estimated annual gain of \$1-2bn only allows for gains from company tax rate and accelerated depreciation changes – further gains from remainder of package

Outline

- Industry Effects of Tax Reform
- General Effects of RBT
- Comments on RBT Measures

Comments: Positive

- Lower company tax rate
 - more internationally competitive
- Abolition of accelerated depreciation
 - more neutral choice between investments
- Anti-avoidance measures
 - e.g. alienation of personal services income

Comments: Mixed

- CGT changes
 - more internationally competitive rate (+)
 - abolition of indexation (-)
 - overall ?

Comments: Omissions

- Inflation adjustment to interest income and payments to lift saving:
 - interest income is over-taxed
 - interest payments get excessive deductions
- Taxation of hotel-type clubs as hotels:
 - annual revenue gain of \$200m