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Company tax and the productivity agenda

Submission to the Productivity Commission

The present submission follows the Productivity Commission's request for submissions on cutting the company tax. We advance a number of reasons why the company tax should not be cut. We also point out problems with any company tax cut proposal including that the lower tax would mean lower tax refunds for the owners of the company thereby nullifying any alleged benefits.

The Australia Institute Submission

David Richardson

June 2025

The Australia Institute - Research that matters

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Acknowledgements

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Summary

The present submission follows the Productivity Commission's (PC) request for submissions on cutting the company tax. This debate echoes the one nearly a decade ago with the then Coalition government's proposal to reduce company tax, which failed to pass the Senate. In the time since then, there seems to have been a global settlement to prevent further races to the bottom in cutting company tax rates. Nevertheless, the PC seems to be attempting to reopening that debate and taking it for granted that a lower company tax would boost productivity.

We provide a brief introduction to Australia's company tax arrangements and then outline the arguments against cutting tax. First, company tax is a good tax which companies only pay when they cover all their costs. Second, US President Donald Trump's 2017 company tax cuts did not achieve their goals. Third, company tax is a significant revenue raiser even after taking account of the effect of franking credits. A company tax cut is bound to be associated with measures that would reduce valuable government services and income support.

Among the undeserving beneficiaries of a company tax cut would be the big four banks, which already generate huge economic rents. The other main beneficiaries would be foreign shareholders and tax avoiders. We demonstrate that Australia's own history of gradual reductions in company tax cuts has not been accompanied by an upward trend in investment. Likewise, there has been no upward trend in foreign investment. The lion's share of the benefits would go to the top 15 taxpayers in Australia which are the big banks and miners. Significantly this list also includes various Australian monopolies, duopolies and oligopolies, which already make super normal profits, and which have little incentive to invest in productivity-enhancing technology and equipment due to their market power.

There are better ways to boost Australia's productivity and, indeed, to boost private investment. We briefly outline some of those though this submission is not the place for a large discussion of such things. Finally, we point out how the company tax cut agenda is inconsistent with economic theory.

Introduction

> Christine Lagarde, CEO of the International Monetary Fund, warned of a 'race to the bottom' and said that cuts in company taxes, regulation and trade would have 'devastating effects'.[1]

The Productivity Commission (PC) has called for submissions to its inquiry into measures that might improve Australia's productivity performance. Our submission focuses on *Pillar1: Creating a more dynamic and resilient economy*, specifically the identified policy reform area: *Support business investment through corporate tax reform* to which you add "A more effective corporate tax regime can help Australia attract foreign capital, and spur businesses to invest, innovate and improve labour productivity."[2] Later the PC adds "This helps improve living standards, and helps Australia become a more dynamic and resilient economy".[3]

This quote makes it perfectly clear that the PC has decided it will recommend cutting company tax rates. The PC may, however, be unclear on how it wants to make those cuts. It says:

> Effective company tax rates can be changed in a variety of ways. These include changes to tax rates themselves, or changes to the company tax base… In this inquiry we will evaluate options to support business investment and productivity growth through changes to Australia's corporate tax arrangements.[4]

To support its assertion that changes to company tax boosts investment, the PC cites three treasury documents including the Henry Tax Review, one IMF discussion on Australia and an OECD discussion with a substantial section on Australia. The latter hardly mentions company tax in the general chapters and the Australian section only very superficially. The others present views about how company taxes work but no evidence to that effect. Some rudimentary economic theory is appealed to but, as we argue below, those views contrast with others such as Nobel Prize winner, Joe Stiglitz. Not only this, but there is no mention of Treasury produced modelling undertaken during previous debates on the topic, which showed Australian investors may even be worse off as we discuss below.

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[1] Cox J (2017) 'Davos: IMF Chief warns against cutting taxes and regulation 'to the bottom' referencing Donald Trump's policies', *Independent*, 20 January.

[2] PC (2025) "Creating a more dynamic and resilient economy", at https://engage.pc.gov.au/projects/dynamic-resilient-economy

[3] Productivity Commission (2025) *Creating a more dynamic and resilient economy* at https://engage.pc.gov.au/projects/dynamic-resilient-economy/page/corporate-tax-reform

[4] Productivity Commission (2025) *Creating a more dynamic and resilient economy.*

In the earlier company tax debate, the argument about benefits to Australians seemed be lost and the then Coalition government concentrated on benefits for foreign investors. The change from the general to a particular focus on foreign investment implicitly acknowledges that with the complications of dividend imputation there is no benefit to Australian owners of capital.[5]

> The other Keating, former head of Prime Minister and Cabinet, Mike Keating, remarked: Frankly it is hard to think of reasons why this extension of the company tax cut would represent value for money, as it is unlikely to make much difference to investment nor growth. Indeed, company tax has been cut by a lot over the last few decades in a lot of countries, but in no country was there a significant impact on investment, output or employment.[6]

Below we explore how lowering company tax benefits foreign shareholders who cannot participate in Australia's dividend imputation system.

In the next section we outline some basic concepts that assist in understanding the debates about company tax.

[5] The role of dividend imputation and how foreign and Australian capital owners are treated differently was discussed in Kouparitsas M, Prihardini D and Beames A (2016) 'Analysis of the long term effects of a company tax cut', Treasury Working Paper No 2016-2, May; and Dixon JM and Nassios J (2016) 'Modelling the impacts of a cut to company tax in Australia', Victoria University Centre of Policy Studies Working Paper, No G-260, April.

[6] Keating M (2016) 'Mid-Year Economic and Fiscal Outlook, 2016', 21 December at http://johnmenadue.com/blog/?p=8753

Companies and company tax arrangements

Companies

A company is a separate legal entity with its own obligations, is run by its directors and owned by its shareholders. A company that makes a profit is able to distribute dividends to its shareholders and those dividends may be taxable in the hands of the recipient if they reside in Australia. Incorporating as a company has many advantages but comes with a range of reporting and other legal requirements. The principal advantages are:

- **Liability protection**: A primary advantage of incorporation is the protection of the owners' private assets through limited liability.
- **Taxation benefits**: Company tax may be lower for individuals running a business that being taxed as individuals.[7]

We need to remember that the advantages of the corporate structure are a gift of the state and not the outcome of market forces. These advantages are important to keep in mind and, arguably, should come with some sort of responsibility that includes paying a fair level of tax. Not only that, but the health of the Australian corporate sector also depends critically on the provision of a trained workforce and the provision of infrastructure such as roads, rail and other transport, a legal infrastructure, and so on. Most of those things are free of charge for the corporate sector.

Company tax

The company tax is a special adaptation of the income tax designed to fit the circumstances of the corporate sector. Company taxation is provided for under the *Income Tax Assessment Act 1997*.

Company tax is effectively payable on the profit of the company subject to many qualifications. Profits are equal to company income or receipts minus expenses such as the wages bill, rent, the cost of inputs and other items that contribute to the operation of the business. Certain items are not deductible as an expense. Dividends paid to shareholders are an obvious example of a company payment that is not an expense but is a distribution of the profits of the company. On the other hand, interest paid to lenders is a legitimate

[7] This relies on Young E (2023) "What Are the Advantages of Incorporating a Company?" LegalVision, 14 February at https://legalvision.com.au/what-are-advantages-incorporating-company/

expense. There are many provisions of the company tax that we can ignore for the purposes of this paper.

At present, the general company tax rate is 30% but, for smaller companies with a turnover below $50 million, the tax rate is 25%. We have estimated that 30.9% of the company tax collected is given back to shareholders as franking credits.[8] In discussing the Australian tax system it is important to understand franking credits which are generated as part of Australia's dividend imputation system. The dividend imputation system is explained in an appendix.

What are franking credits?

When a taxpayer files a tax return, they must include any dividends and declare whether they are franked dividends or not. Franked dividends have attached franking credits which are used to reduce the taxpayer's tax liability. Franking credits are a creature of the dividend imputation system which, in brief, treats company tax as a pre-payment of tax on behalf of the company's owners, the shareholders. Hence a high-income earner may face a 47% tax rate (including the Medicare levy) and receive credit for the 30% tax paid by the company. The appendix explains how the dividend is grossed up to determine the tax liability to which the credit applies.

[8] This figure is the author's calculation based on franking credits received by individuals, super funds, partnerships and trusts and the overall company tax paid. The data came from ATO (2024) *Taxation statistics 2021-22* at https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/taxation-statistics/taxation-statistics-2021-22.

Arguments against cutting company tax rates

Business groups and large corporations argue that tax cuts will boost productivity. The logic is that if business profits are higher, they will invest more and by applying more capital to their business, productivity will grow. Most of the present submission seeks to examine those links.

In the 2016-17 Budget, the Coalition Government announced plans to cut the tax companies would be required to pay.[9] The Australia Institute and others fought those plans with the result that the Senate voted against the plan and the full cuts were never introduced. Rather there was a settlement with the status quo for companies with a turnover above $50 million and a 25% rate for companies below that threshold. The arguments then were much the same as the ones now. However, the present context has investment and productivity growth as a major focus of the inquiry.

We now outline some of the objections to cutting the company tax rate.

1. The company tax is a good tax

The company tax applies to a company's profit and profit is a residual. It is the difference between sales receipts and costs. Profit is net of financing costs as well as all other costs. That may seem a trivial thing to say, but profit as a residual is not a cost at all. We can agree that many costs might change a company's behaviour in one way or another but taxing the residual is different. A higher or lower company tax cannot tip a profitable enterprise or project into a loss maker or vice versa. In that way a company tax works in a completely different way from other taxes or costs. The former CEO of Qantas, Alan Joyce, appreciated this point some years ago when he reflected on Qantas' experience and said:

> I think we were on the list of companies that didn't pay tax back in 2014…Yes, we lost $2.8 billion back then, and a corporation tax is a tax on profits, and we didn't make profits, but we paid a billion dollars in tax on tickets. We collected well over one and a half billion dollars of GST which was a tax on our product. We paid payroll tax. We paid carbon tax. We paid all sorts of other taxes…I hope, now that we are making money, we will be paying a lot of corporation tax in the future.[10]

[9] These plans were expressed in Australian government (2016) Budget Paper No 2. Budget Measures 2016-17, at https://archive.budget.gov.au/2016-17/bp2/BP2_consolidated.pdf

[10] Hewett J (2016) 'Business wakes up to reform mirage', *Australia Financial Review*, 2 March

The argument soon gets very technical so that discussion is left for the technical appendix. Suffice it to say that economic theory does not support suggestions that company tax cuts encourage investment.

2. Don't follow Trump

The Republican plan that is presently before Congress (May 2025) calls for roughly US$3.8 trillion in tax cuts — the bulk of which would come by extending the 2017 Trump tax cuts which gave massive benefits to companies and the rich. Those cuts were due to expire at the end of the year, 2025. Among other things, Trump's earlier tax cut replaced the graduated corporate tax structure with a flat 21% corporate tax rate. Including state taxes, that means that the total American rate would be around 25 per cent.

Then Treasurer Scott Morrison and former head of the Business Council, Jennifer Westacott, said at the time that to remain competitive, Australia had to meet Trump's plan. However, calls for Australia to cut its rate on the basis of Trump proposed cuts failed to acknowledge analysis from top US economists arguing that the Trump plan will not work to increase either jobs or economic growth.[11] Economist Jane Gravelle of the Congressional Research Service has found that there is no relationship between tax rates and economic growth.[12] The US had an experiment with cutting company taxes dramatically in 1986 from 46 to 34 per cent but the evidence does not show an increase in economic growth. The evidence showed that rather than increasing investment and growth, the tax cuts tended to be spent on share buybacks and higher dividends.[13] More recent research on the 2017 tax cuts points to spending on buybacks out of most of the additional profits made since the 2017 tax cuts.[14]

In their submission before the 2025-26 budget, the Business Council of Australia (BCA) argued that Trump's plans to lower company tax in the US means we must reduce Australia's company tax—just like they argued almost 10 years ago. The BCA suggests that Australia's investment "all but dried up" when the American rate was reduced to 21 per cent in 2017.[15] This is interesting given the actual evidence. Reports from the IMF and other

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[11] Contemporary critiques are summarised in Richardson D (2017) "Trump's tax plan Australian perspective", at https://australiainstitute.org.au/wp-content/uploads/2020/12/P452-PRINT-Trump-tax-plan-and-the-Australian-response.pdf

[12] Gravelle JG (2017) 'Corporate tax reform: Issues for Congress', *CRS Report*, 22 September

[13] For example, Cassidy J (2017) 'A White House fairy tale about the Trump tax plan', *The New Yorker*, 20 October

[14] Perkins T (2025) "Top US companies spent three times as much on buybacks as taxes afer Trump cuts – report", *Guardian*, 9 April, at https://www.theguardian.com/us-news/2025/apr/09/trump-tax-cuts-stock-buybacks#:~:text=Eleven%20top%20US%20consumer%20goods,according%20to%20a%20new%20report.

[15] Mckenzie M (2025) "Business Council of Australia: Cutting company tax would bring in investment and boost economy", *West Australian*, 12 February at https://thewest.com.au/business/economy/business-council-of-australia-cutting-company-tax-would-bring-in-investment-and-boost-economy-c-17697654

researchers were unable to find surges in American investment as a result of the tax cuts, though there were modest investment increases due to the stimulatory environment at the time. However, share-buybacks increased significantly that seem to have been encouraged by the corporate tax cuts.[16]

3. Giving business a $83 billion dollar tax cut means billions of dollars less for schools, hospitals and other services.

We estimate that cutting the 30% company tax rate to 25% would give business a $83 billion dollar tax cut over the forward estimates (2025-26 to 2028-29). This estimate is based on projected tax receipts and adjusts for the amount of tax already collected at the 25% rate which applies to companies with turnovers at less than $50 million.[17]

The company tax cut would mean billions of dollars less for services like schools and hospitals. Treasury modelling during the earlier company tax cut debate may have inadvertently revealed secret plans when it assumed the earlier proposed company tax cuts would be matched by cuts to services and higher individual taxes.

We should point out here that not all of a company tax cut would be lost to the revenue. Based on 2021-22 Tax Office data we estimate that 31% of the company tax collections were returned as franking credits to individuals, super funds, partnerships and trusts.[18] That would turn our estimate of $83 billion into $57 billion as the total revenue effect of reducing the company tax rate.

4. The big four banks would get an extra $9.4 billion dollars.

Australia's big four banks are some of the most profitable banks in the world and have been making record profits.

[16] Ross J (2024) "The tax cuts and jobs Act failed to deliver promised benefits", *American Progress*, 30 April.

[17] The sources are Australian Government (2025) *Budget paper no 1: Budget strategy and outlook* at https://budget.gov.au/content/bp1/download/bp1_2025-26.pdf, and Australian government (2024) *2024-25 Tax Expenditures and Insights Statement*, at https://treasury.gov.au/sites/default/files/2024-12/p2024-607085-teis_0.pdf

[18] ATO (2024) *Taxation statistics 2021-22* at https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/taxation-statistics/taxation-statistics-2021-22

Our research shows a 5-percentage point tax cut would net the big four banks an extra $9.4 billion dollars over the forward estimates.[19] The big banks do a lot of lending but hardly any investing and they are very unlikely to undertake any more investment as a result of any tax cut.

5. The big winners are foreign shareholders and tax avoiders.

> Paul Keating: Do you know any foreigners you want to give 5% of our national company income to? Any deserving cases out there? Or should we leave the company tax rate where it is, as a withholding tax, for the promotion of Australian investment and for the benefit of Australian taxpayers?[20]

The big winners from the company tax cut are tax avoiders and foreign shareholders. The benefits of the company tax cut mostly go to foreign shareholders, not to Australian shareholders due to Australia's dividend imputation system.

If a 25% universal company tax were fully implemented, foreign shareholders would benefit to the tune of $17 billion or so every year.

The $17 billion estimate is a rough approximation, but a very conservative one, based on the following considerations. Balance of payments figures show $99.7 billion left Australia as dividends in companies or shares in investment funds for the calendar year 2024. These are payments made from after-tax profit to foreign shareholders. If the companies that paid these amounts were taxed more lightly at 25% they would have had, at least, an extra $17 billion to distribute. Not all of it need be distributed but if not, those undistributed amounts would remain in the company and would increase the value of the company accordingly.

Australian shareholders are in a fundamentally different position with regard to company tax.

Tax avoiders would also welcome this change. A good deal of tax is avoided in Australia by people trading, not as an individual on a maximum tax rate of 47%, but as a company. The earlier change in the company tax rate down to 25% would have already benefited many of those.

[19] Author's estimate based on APRA data for 2023-24 projected forward at the same rate as government budget paper estimates for nominal GDP growth. See APRA (2025) Quarterly authorised deposit-taking institution statistics at https://www.apra.gov.au/quarterly-authorised-deposit-taking-institution-statistics and Australian Government (2025) Budget Paper No. 1: Budget Strategy and Outlook at https://budget.gov.au/content/bp1/index.htm

[20] Keating PJ (2013) 'Dividend imputation and superannuation are worth fighting for', *Cuffelinks*, 21 February.

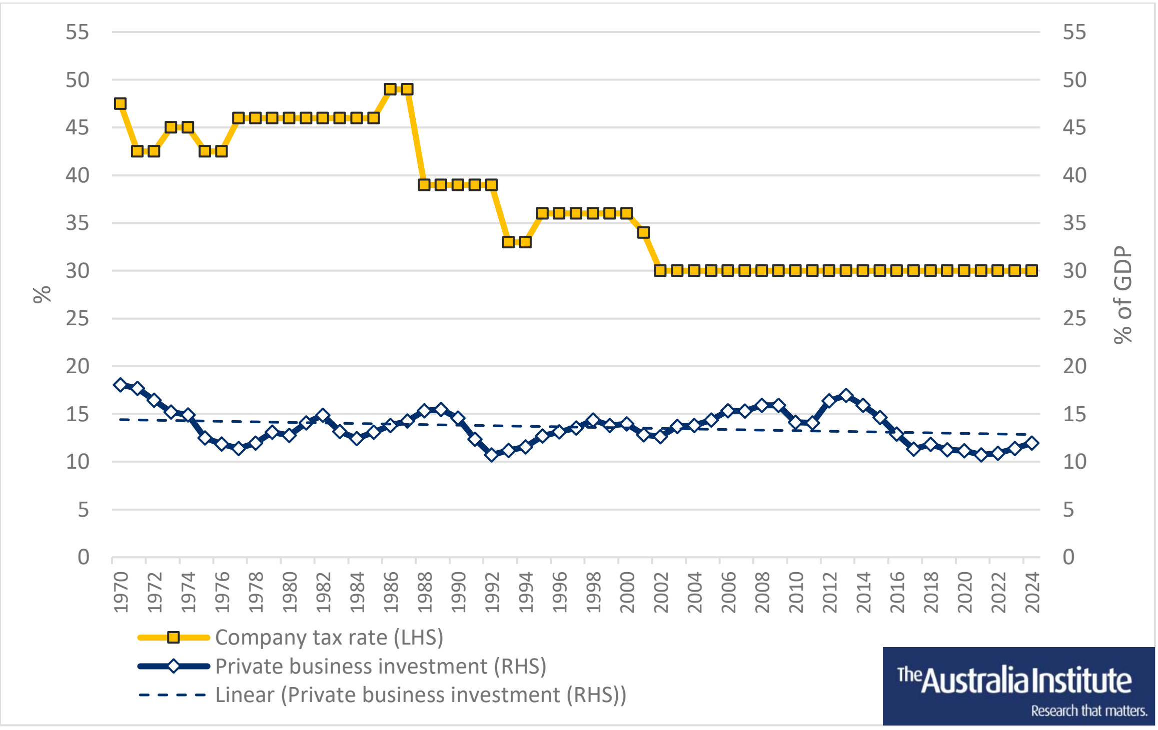
6. There is no correlation between lower company tax rates, employment, or economic growth.

The fundamental logic behind the reasoning for a company tax cut is faulty. Coles or Woolworths are unlikely to invest more if they pay less company tax – there is little incentive to do so given their virtual duopoly of the market. **There is no correlation between lower company tax rates, employment, or economic growth.** Common sense shows this, and historical and international data confirm it. In the present exercise the PC only seem concerned with investment, but it is important to remember there are very few other benefits of lower company tax cuts.

Of course, while the economic activity may not be sensitive to tax rates, companies will be keen to avoid tax by making their profits appear to derive from tax havens. Countries such as Australia have no hope of competing against tax havens and, it is worth noting that the international community has undertaken a lot of common action against tax avoidance/evasion.

Our 2016 paper *Company Tax: What the Evidence Shows* points to the behaviour of tax rates and investment in Australia. From 1970 to 2025 company tax rates have fallen from a high of 49% in the late 1980s and then were lowered to 30%.

Figure 1: Company tax rate (LHS) and private business investment (RHS)



Source: Author's calculations based on ABS (2025) *Australian National Accounts: National Income, Expenditure and Product, December 2024*, 5 March.

Figure 2 clearly shows that there is little or no correlation between investment and company tax rates. If anything, there is a barely significant downward trend in the investment ration as shown by the trend line in Figure 2. The very small upward movement after the 1990 recession may well be the result of privatisations which transferred big utilities and other entities to the private sector. Also, the period from about 2004 includes the mining boom which was unrelated to tax rates and instead concerned demand for iron ore from China.

It is worth noting that that company tax rate shown in Figure 2 is not the tax rate as it applies to the ultimate shareholders. Until the late 1980s, companies faced much higher taxes on retained profits but, the introduction of dividend imputation in 1989 meant that domestic companies paid a maximum of 49 per cent on their income. Dividends received by the domestic taxpayer have attached franking credits that, in effect, give the taxpayer a credit for company tax paid on their share of the company profit.

Before dividend imputation there was no integration between the two tax systems. For example, in 1977-78 the company tax rate was 46 per cent and the top marginal tax rate was 65 cents in the dollar, the combined effect of which was a tax rate on the original company income of 81.1 per cent by the time it was received in the hands of the domestic investor, the ultimate owner. Other years had even higher rates. Hence for ordinary Australian investors on the top marginal rates, income derived from the corporate sector was once taxed at more than 80 per cent. This is now 47 per cent.

7. Other factors much more important for investment and productivity

Every month the National Australia Bank surveys employers about the economic conditions they face, what determines their confidence and what they expect in the future. Invariably business cites demand factors and capacity utilisation as fundamental to hiring and investment intentions.[21]

Public infrastructure is also important. One survey of the field remarked:

> The economic impact of public investment in infrastructure has been at the center of the academic and policy debate for the last two decades. Infrastructures generate positive externalities to the private sector, contributing to the well-being of households and the productivity of firms. Therefore, it is hardly surprising that in many countries development strategies have been based on infrastructure

[21] See for example, *NAB Monthly Business Survey Apr-25* at https://business.nab.com.au/wp-content/uploads/2025/05/NAB-Monthly-Business-Survey-April-2025-.pdf

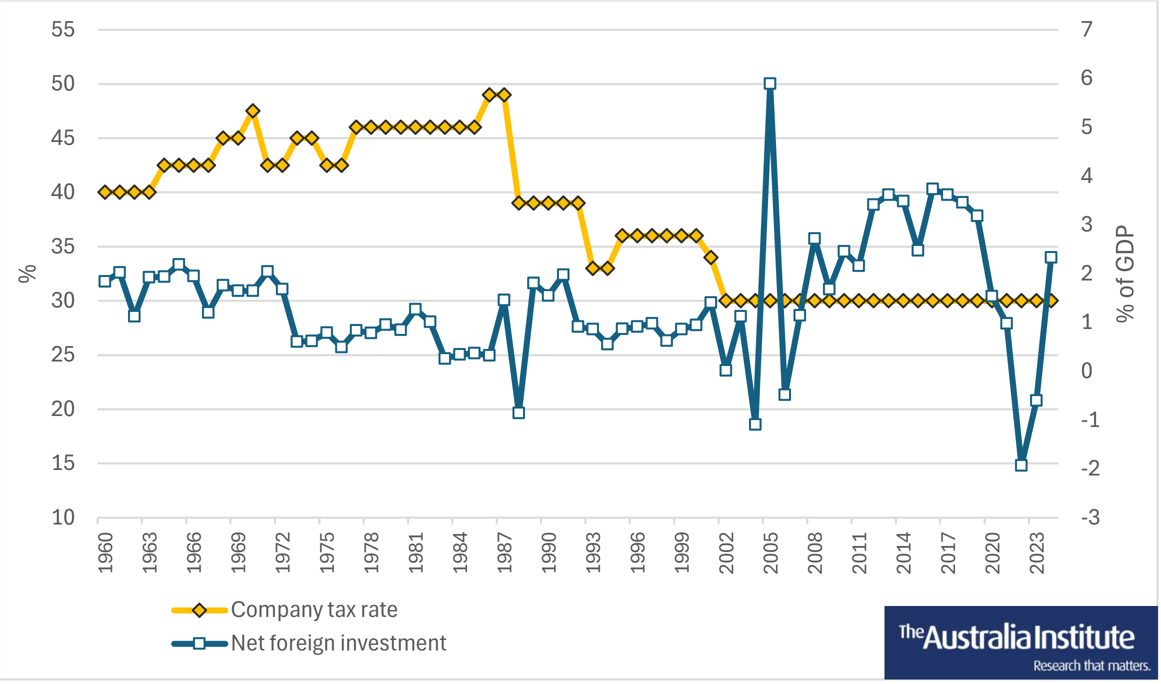
investments while in others the failure to achieve adequate growth has been attributed to a lack of adequate infrastructures. The examples are many.[22]

This is not the place to explore infrastructure spending in detail except to note its benefits and address the 'fear of debt' on the part of the states and territories.[23]

8. Companies do business in Australia because they want to do business in Australia

Foreign investment is not dependent on the company tax rate. In fact, most of Australia's foreign investment comes from countries with lower tax rates. More important, the data do not confirm a hypothesis that says lower company tax rates are associated with more foreign investment. Figure 3 shows how the company tax rate and the level of net foreign direct investment behaved since 1960.

Figure 2: Company tax rate (LHS) and foreign investment (RHS) as a share of GDP %



Source: Author's calculations based on ABS (2025) *Australian National Accounts: National Income, Expenditure and Product, December 2024*, 5 March and ABS (2025) *Balance of Payments and International Investment Position, Australia, December 2024*, 4 March.

[22] Pereira AM, Andraz JM (2010) "On the economic effects of public infrastructure investment: A survey of the international evidence", *College of William and Mary Department of Economics Working Paper Number 108* at https://economics.wm.edu/wp/cwm_wp108.pdf

[23] Freebairn J and Corden M (2013) "Vision Versus Prudence: Government Debt Financing of Investment", Melbourne Institute Working Paper No. 30/13.

To the extent that any trends are apparent in Figure 3 the trend line suggest almost no change in net foreign investment over the period shown despite the resources boom. There is certainly not enough evidence to suggest lower company tax cuts encourage foreign investment.

The OECD noted, "it is not always clear that a tax reduction is required (or is able) to attract FDI. Where a higher corporate tax burden is matched by well-developed infrastructure, public services and other host country attributes attractive to business… tax competition from relatively low-tax countries not offering similar advantages may not seriously affect location choice. Indeed, a number of large OECD countries with relatively high effective tax rates are very successful in attracting FDI."[24]

Internationally the World Bank survey of enterprises, says

> The top three factors influencing investment decisions are political stability, macroeconomic stability, and a country's legal and regulatory environment; nearly 9 in 10 businesses consider them to be "important" or "critically important." These factors rank ahead of considerations such as low tax rates, low labor and input costs, and access to resource endowments.[25]

These surveys are based not on OECD countries with their relatively small differences in tax rates but include all countries including those with tax-free incentives and tax havens. Nevertheless, company tax comes out as a very low consideration.

9. Just 15 companies would share 30% of the benefits of the cut

Just 15 companies will receive 30% of the benefits from the company tax cut.[26] Eleven of the top 15 tax-paying companies in 2022-23 were miners, including Rio Tinto, BHP, Glencore, Chevron, Fortescue, Woodside, Mitsubishi, Yancoal, Shell and Windfield. The remining companies in the top 15 were the 4 banks, the Commonwealth, Westpac, National Australia Bank, and ANZ. It is faulty to argue that the mining companies need any further tax concessions in order to encourage them to investment. Similarly, the big four banks operated within a protected oligarchy – the lack of competition actively disincentivised

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[24] Chowdhury A (2018) "Scare Tactics for Corporate Tax Cuts Do Not Stand Fact Checks", *Between the lines*, 20 January at https://australiainstitute.org.au/post/scare-tactics-for-corporate-tax-cuts-do-not-stand-fact-checks

[25] World Bank (2020) *Global Investment Competitiveness Report 2019/2020: Rebuilding Investor Confidence in Times of Uncertainty*, Washington, DC: World Bank Group.

[26] This compares the top 15 taxpayers with the budget papers figure for total tax collections for 2022-23. Top taxpayers are given in ATO (2024) *2022-23 Report of Entity Tax Information*, at https://data.gov.au/data/dataset/corporate-transparency/resource/3281f733-6f53-431b-84f5-d824c6bd9e60

productivity enhancing investment, and as noted earlier, the finance sector is not a major investor. In recent times governments have tried to increase taxes for miners and banks through the rent taxes and bank levy. In other years there are likely to be fewer miners among the top 15 taxpayers and more monopolists, duopolists, and oligopolists such as Telstra, the insurance companies, IAG and QBE, electricity suppliers, AGL, EnergyAustralia and Origin, and so on. If anything, tax rates on these should be increased in line with their huge economic rents.[27]

None of the big 15 companies are likely to be big innovators or investors in the near future and it is hard to see what investment or any other return Australians would receive in return for a $7.4 billion gift.[28]

10. There are better ways to boost private investment.

There are way more cost-effective ways to encourage investment and help the economy. The basic rule of thumb is that if you want to encourage something you should single it out and subsidise it. Indeed, a lot of the capital shortages experienced at the moment are in areas such as infrastructure that require public funding which is not assisted by reductions in revenue.

Research by the Reserve Bank of Australia shows that investment in Australia is far from responsive to changes in financial conditions. The RBA had been concerned that in fact investment has not responded to successive reductions in the 'cost of capital' flowing from official interest rate changes.[29] The RBA also notes that business decision-makers are also interested in a great deal more than just the price. Both these points amount to fundamental criticisms of any modelling that uses only the 'cost of capital'. The implication of the RBA research is that substantial market failures are endemic in the modern Australian economy which in practice makes it very hard to model investment behaviour. Of course this is no more than we should expect given that the textbook model of the economy is a very extreme characterisation of economic systems to the extent that no-one actually believes those models apply in the real world.

PwC and others advocated company tax cuts because the argue this will lead to higher economic growth through higher employment, higher investment and more innovation. Joseph Stiglitz, however, points out that if you are interested in fostering more investment

[27] Economic rent is profit over and above the profit required to keep businesses in the industry. In theory, economic rent can be taxed without generating incentives for business to slow down their activity.

[28] The top 15 companies paid tax of $44.3 billion at 30% and might be expected to pay $7.4 billion less or $36.9 billion.

[29] Lane K and Rosewall T (2015)'Firms' investment decisions and interest rates', *RBA Bulletin*, June Quarter, pp. 1-7.

by corporations then "there are more precise ways to tweak the tax code than an across-the-board cut: it [the Bowles-Simpson Deficit Reduction Commission which recommended company tax cuts] could have suggested lowering the tax on firms that created jobs and invested in America and raising taxes on those that didn't. Such a policy would raise revenues and provide incentives for more investment and job creation in the United States".[30]

Stiglitz' argument thus asserts that if there is a view that employment, investment, innovation or other priorities need to be addressed then those priorities should be directly targeted rather than using very blunt instruments such as across-the-board company tax cuts which, as the rest of this paper demonstrates, are mainly wasted on large corporation that are not going to innovate and invest.

Studies show that investing in schools and education is more likely to help the economy than giving businesses a company tax cut. Likewise, the large productivity gains likely from increases in spending on government infrastructure.

11. Some of the claimed benefits are based on flawed assumptions.

The idea that cutting the company tax rate would suddenly cause multinational corporations to stop avoiding tax (optimistically termed a "morality dividend") is clearly overblown, if not ridiculous. This is just one of the bizarre assumptions in the economic modelling that claims to show company tax cuts help the economy.[31]

However, it is important that the red herring of international tax avoidance has been raised because it highlights an important factor. Obviously, business will try to argue to the tax authorities in any country that some of their profits are made outside that country's jurisdiction and in other countries with lower tax rates. That search for advantageous tax arrangements should not be mistaken for genuine business looking for low tax jurisdictions.

12. Evidence from Trump's company tax cuts — they did nothing for employment *or* investment.

What did we see instead?

- Big benefits to rich shareholders through share buy-backs and dividend increases, and

[30] Stiglitz JE (2012) *The price of inequality: How today's divided society endangers our future*, WW Norton: NY
[31] See Murphy C (2016) "Company tax scenario", *Report for Treasury*, 28 April.

- An increase in mergers and acquisitions that benefit corporate executives and make big business even bigger.

A recent assessment of the original Trump tax cuts says:

> more than six years later, there is little evidence that the law's costly corporate tax cuts delivered promised growth or improved well-being for the vast majority of the nation's workforce. Instead, the law provided the largest tax cuts to the wealthy and profitable corporations, exacerbated inequality, and eroded revenues that could otherwise have been used to address national priorities.[32]

This report also cites IMF research that shows that the little, or no investment response may reflect the increased corporate market power which means cuts in tax merely increase monopoly profits.

Some assessments have shown small increases in investment following the Trump tax cuts albeit less than expected by the proponents. However, a study that adjusted for the pre-existing trend in investment and compared with other countries found no change to the underlying investment to GDP trend.[33]

13. Vital public services and infrastructure will be the first to go.

Other observers have pointed out that following corporate tax cuts in America, welfare benefits and access to health insurance were slashed, funding 'financial windfalls' for the very rich. The World Bank has commented on the cuts to welfare that tend to follow tax cuts for companies and the rich.[34]

14. The thinking behind reducing company tax is inconsistent with economic theory.

The reasoning of why Australia's company tax rate should be cut is demonstrated by Professor John Freebairn in 2016 when he advocated for a cut to the rate by asserting that "No doubt there are some mines that have an investment that wouldn't work at 30 per cent

[32] Ross J (2024) "The Tax Cuts and Jobs Act Failed To Deliver Promised Benefits" *American Progress*, 30 April at https://www.americanprogress.org/article/the-tax-cuts-and-jobs-act-failed-to-deliver-promised-benefits/

[33] Gale WG, Hoopes JL and Pomerleau K (2024) "Sweeping changes and an uncertain legacy: The Tax Cuts and Jobs Act of 2017", *Journal of Economic Perspectives*, Vol 38(1), pp 3-32.

[34] World Bank (2020) *Global Investment Competitiveness Report 2019/2020: Rebuilding Investor Confidence in Times of Uncertainty*, Washington, DC: World Bank Group

but will work at 28.5 per cent".[35] This example, however perfectly demonstrates the reason for not cutting company tax rates. Company tax is not equivalent to any other business cost. It a company does not make a profit, it is not liable to pay any tax and in that respect the company tax is fundamentally different to other costs and indeed other taxes and levies such as payroll taxes and mineral royalties. The mine in the above example would still be profitable at 28.5% (or any other rate) otherwise it would not pay a company tax at all. That of course is fundamentally different from, say, an increase in the cost of capital through an increase in the rate of interest which will increase the cost of borrowing as well as increasing the opportunity cost of capital. Likewise, many other taxes and government charges are payable whether or not the company makes a profit. For example, the iron ore royalty rate in WA is 7.5 per cent of the value of the iron ore mined.[36] If the mining company receives $100 a tonne, pays $7.50 in royalties and has expenses of $95/tonne it will run at a loss as a result of the royalty. There is no way a profit related tax can do that.

[35] Mather J (2016) 'Benefits of company tax cut would flow to foreigners, then workers', *The Australian Financial Review*, 22 March.
[36] Western Australia Government (2015) *Mining Regulations 1981*.

Appendix 1: Dividend imputation and franking credits

The design of Australia's company and personal taxation systems aims to prevent the so-called 'double taxation' of dividends. Before dividend imputation was introduced the double taxation of dividends occurred as a result of the interaction of the company and the personal income tax systems. A company that earns a profit is liable to pay company tax. It may then pay a dividend to its shareholders who, in turn, are also liable to pay tax. There was some concern that the final after-tax income of the shareholder might be a small proportion of the original company profit. The dividend imputation system was designed to address those concerns through refunds to individual taxpayers to reflect the tax paid by the company and imputed to the individual shareholder. A numerical example helps here.

Take a company which makes a profit of $100. Assuming it has no deductions etc it will pay company tax at 30% (or $30) leaving it with an after-tax return of $70. That $70 might be retained by the company or it may be paid out to shareholders as dividends. If the $70 is paid as dividends, then those dividends are again assessable in the hands of the dividend recipient. A dividend recipient may be an individual shareholder or a trust, partnership, super fund or another company. For simplicity assume the dividend recipient is an individual. Now the $70 dividend is assessable income in the hands of the recipient but under the imputation system credit is given for the tax already paid by the company.

We now outline how that is done.

Every $70 received as a dividend by an Australian individual taxpayer is 'grossed up' and taken to be the original $100 in working out the personal tax liability. However, the company tax paid, the $30, is credited against the individual's tax liability. Hence if the shareholder is on a 47 per cent marginal tax rate (including the Medicare levy) the tax on the 'grossed up' dividend of $100 is assessed as $47. A 'franking credit' of $30 representing the company tax already paid is recognised and a net liability of $17 is payable by this individual to the tax office. That leaves $57 (=70+30-47) in the hands of the shareholder with the tax office receiving $47, $30 from the company and $17 from the individual.

The net effect in this example is as if the company paid no tax and the individual is taxed on the full amount at the appropriate marginal tax rate. If the franking credit exceeds the actual assessed tax liability (for example, if the dividend is paid to a low-income earner not liable to pay tax) then that taxpayer receives a cash payment for the difference subject to residency, etc. The cash payment is important in the case of other entities taxed at low rates, such as super funds. We referred earlier to the amount credited against the individual's tax liability as a 'franking credit'. Companies that pay tax maintain a franking credit account and can declare a franked dividend, so long as the franking credit account maintains a positive balance.

We estimate that 30.9% of the company tax collected is given back to shareholders as franking credits.[37]

[37] This figure is the author's calculation based on franking credits received by individuals, super funds, partnerships and trusts and the overall company tax paid. The data came from ATO (2024) *Taxation statistics 2021-22* at https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/taxation-statistics/taxation-statistics-2021-22.

Appendix 2: Economic theory discussion

Much of the economics theory used by proponents of company tax cuts is wrong

During the 2016 company tax debate the KPMG modelling based on their understanding of the economic processes at work. [38] Their main result was that a cut in company tax will boost the economic indicators we care about. The main mechanism was the assertion that cutting company tax rates reduces the cost of capital, which increases investment which results in the substitution of capital for labour resulting in both higher capital/labour ratios and higher productivity, output per head. However, the model virtually assumes what it wants to demonstrate. Once certain assumptions are fed in, the only uncertainty is the order of magnitudes involved in the final results and after all the feedback effects.

Problems with the above account

Economists tend to assume that the objective of business is to maximise profit. Generally, you can express profit as revenue minus costs. That in turn can be expressed mathematically as a function of output – the level of production. To maximise profit the business will produce more output until profits peak. Mathematically that means marginal revenue equals marginal cost and the business can pick the quantity to produce for maximum profit. But mathematically the conditions for maximising profit will be the same as the conditions for maximising 70% of the profit which means the after 30% profit condition for maximum profit is exactly the same as the condition for maximising 100% of the profit, or any other figure for that matter. This reinforces Stiglitz's point that taxing profit is fundamentally different from other taxes such as payroll, GST, energy and so on.

In the case of a corporate entity looking to invest, the essential argument is that investment will take place until the return on the marginal investment is just equal to the cost of capital and that will be true whether or not the company needs to borrow or can meet the investment cost out of retained earnings. Increases in the company tax rate will reduce the after-tax return on the investment but that is balanced by increases in the value of interest deductions (or increase the tax on returns from keeping retained earnings in the bank). It is still profitable for the company to keep investing until that point. Hence Stiglitz says that the

[38] KPMG (2016) *The economic impact of a GST-funded company tax cut*, 14 January

company tax 'is an infra-marginal tax on the return to capital (or pure profits) in the corporate sector'.[39]

The marginal condition (invest until returns just equal the cost of capital) is unaffected by the company tax rate. In principle that means the company tax rate can be increased substantially without altering corporate behaviour. Stiglitz criticises those who assert that the corporate tax rate introduces an inefficiency by increasing target rates of return on the part of investors. As he says "they confuse the average with marginal cost of capital".[40] It is this confusion that is behind claims that the company tax is inefficient compared with other possible taxes.

If the best company tax system is one that allows you to recoup any capital outlays and generate a normal return on investment, then Stiglitz makes it clear that the tax system is already a good approximation for that.[41] The actual capital outlays on buildings, equipment, software and the like are tax deductable over time using the provisions for depreciation and amortisation expenses. Investments are normally financed through borrowings and, to the extent that interest charges reflect the market rate of return, then interest payments reflecting the normal rate of return are tax deductable. Moreover, the interest charges tend to be composed of a real rate of return plus an inflation component. To the extent that the prices of capital goods follow general inflation trends, then interest charges generate a rate of return sufficient to cover inflation in capital goods prices. If there is 100% gearing of new investment, that is, no shareholder funds are used, then an investment that just breaks even pays no tax but earns the going rate of return. If then the investment produces an accounting profit, that will be equal to the surplus above depreciation, amortisation and financing costs which only exists in companies making above normal rates of return.

In practice companies may not be 100% geared and so some of the measured profit will be part of a normal return on investment. Working in the other direction, most companies will be operating equipment that has been fully or partially depreciated in earlier tax returns, either in full or in part. Hence, Stiglitz can claim the company tax system is a good approximation of a rent tax.

The review of the Australian Tax system by the then Secretary of Treasury, Ken Henry saw the tax on economic rent as being a very good tax because it taxes the inherent profitability of a particular resource. [42] However, the review seemed unaware that the analogous argument applies to profit earned in the corporate sector. Just like a resource rent tax, the company tax rate can be quite high without affecting the incentive to invest and, hence, without affecting behaviour.

[39] Stiglitz JE (1973), p 26.
[40] Stiglitz JE (1973, p 33.
[41] Stiglitz JE (2025) *The Origins of Inequality, and Policies to Contain it*, Oxford University Press.
[42] Henry K (2008) *Architecture of Australia's tax and transfer system*, August.

We now turn to the econometric evidence where, fortunately the US Congressional Research Service has recently done the work and reviewed the empirical evidence that might or might not support claims to the effect that lower company tax rates increase economic growth, boost employment and the like.[43] It generally debunks the notion that lower company taxes are beneficial in the ways usually suggested.

Analyses, such as that by KPMG mentioned above, repeat a common mistake of treating company tax as a cost. Instead, it is a tax on the profit—the residual after all other claimants on the company's revenue have been met. That fact makes company tax fundamentally different. The modelling also assumes away other real-world problems and for example, assumes away dividend imputation when talking about the required rate of return on capital.

Modeling

Modelling is used as a means of cutting off debate about one's position on a contentious issue. In the past it has been sufficient for ministers and treasurers to stifle debate by pointing to the outcomes of the modelling. As it happens, the models are usually only as good as the assumptions fed into them. For example, if you believe that capital and labour are easy and likely substitutes in production you will feed that into the assumptions expressed in the model's equations. The modelers also assume the company tax rate influences the cost of capital despite what we said above. Once you have set up the equations in that way it is then easy to show that a reduction in the cost of capital will encourage investment with consequential increases in GDP investment and other good things. Lo and behold early modelling during the earlier company tax debate showed precisely that, although it must be said that the impact was never all that strong in the studies by Treasury for example.

We unpacked some Treasury work to show that, if believed, it meant a trivial annual increase in GDP for each of the next 20 years. Richard Denniss discussed Treasury's inhouse modelling and some by Chris Murphy that showed that the economy would have doubled by December 2038 but with the earlier planned tax cuts, the doubling of the economy would be brought forward to September 2038. As Denniss at the time noted, "wow, a whole three months earlier".[44] The results therefore suggested that cutting company tax as then planned would raise economic growth by 0.036% which amounts to extra GDP of about $1 billion in 20 years at a cost of around $50 billion at the time. Surprisingly the many critics of government spending and so-called waste were silent on the massive costs of company tax cuts and the trivially small benefits to be delivered.

[43] Gravelle JG and Hungerford TL (2011). *Corporate tax reform: Issues for Congress*, 16 December.

[44] Denniss R (2016) "The public shouldn't trust business groups like the BCA", 14 June at https://australiainstitute.org.au/post/the-public-shouldnt-trust-business-groups-like-the-bca/

At the time of the 2016 Budget the government released a paper on the Treasury modelling of the company tax cuts by Treasury officials.[45] This paper correctly accounted for Australia's dividend imputation system and so showed a benefit to foreign investors but no benefit for Australian investors, indeed there was a small cost to domestic investors. The intuition of this result is that with a lower company tax rate in Australia foreign investors invest more in Australia which drives down the general rate of return somewhat which then impacts on Australian investors.

The result is that any response to a lower Australian company tax comes from foreign investors if indeed there is any response. The Treasury officials' position on the difference in company tax cut incentives for foreign and domestic investors was also emphasised in an earlier study by Janine Dixon.[46] Incidentally both studies suggested trivial benefits if any to Australia and then only after a long transition period with negative benefits in the case of the Treasury officials' paper.

As an aside, the modelling which shows higher GDP as a result of lower company tax rates would not have produced a positive result if the modelling had instead used GNP, gross national product. While GDP measures all domestic activity taking place in Australia, GNP measures economic activity on the part of Australian residents.

The upshot of all this is when you use a model biased in the direction you want, it is still hard to generate anything but trivial benefits and even then the net trivial benefit involves a loss for Australians and a gain to foreign investors.

Demand-led alternatives

The PC would know that that there has been a long tradition in economics that associates the growth in demand with the growth in output and the level of capital accumulation. The National Australia Bank surveys referred to above point to demand factors include trading conditions and forward orders as very important for Australia's economic growth generally and, in particular, the investment climate.[47] Demand factors have been regarded as critical since at least Adam Smith who described increasing returns due to the division of labour made possible by increases in the size of the market.[48] Keynes made output itself depend on the state of aggregate demand and it was a small step to also make investment depend on

[45] Kouparitsas M, Prihardini D and Beames A (2016) 'Analysis of the long term effects of a company tax cut', Treasury Working Paper No 2016-2, May

[46] Dixon JM and Nassios J (2016) 'Modelling the impacts of a cut to company tax in Australia', *Victoria University Centre of Policy Studies Working Paper*, No G-260, April.

[47] *NAB Monthly Business Survey Apr-25* at https://business.nab.com.au/wp-content/uploads/2025/05/NAB-Monthly-Business-Survey-April-2025-.pdf

[48] Deleidi M, Fontanari C & Gahn SJ (2023). "Autonomous demand and technical change: exploring the Kaldor–Verdoorn law on a global level", *Economia Politica,* Vol 40, pp 57–80 at https://doi.org/10.1007/s40888-023-00294-y

demand. Keynes had also pointed out that investment at any interest rate was dependent on the confidence of investors or their "animal spirits". The modern version is Verdoorn's law and is mainly associated with Nicholas Kaldor.[49] Verdoorn's law basically says that it is high aggregate demand that drives increases in productivity and, part of the process is increasing investment caused by demand pressing on the productive capacity thereby encouraging new investment.

[49] Kaldor N (1957) "A model of economic growth", *Economic Journal,* vol *67*, pp 591–624.