We cannot afford unfunded company tax cuts

ACOSS briefing note

April, 2018

Key points

We simply cannot afford more company or personal tax cuts while the budget remains in deficit.

It is inevitable that we'll all have to pay more or wait longer for essential services such as doctor's visits, hospitals, aged care and education, and that social security will but cut further, if the company tax cuts are passed, and personal tax cuts are also given.

The proposed company tax cuts are unfunded. They would cost $1.8 billion in 2019, rising to $14 billion in 2026 ($65 billion over 10 years).

The government predicts a budget surplus in 2020, but these predictions have been proven wrong many times in past budgets.

Any more tax cuts now would come off the back of billions of dollars of budget cuts to health, social security, education, and essential community services since the 2014 budget.

The proposed company tax cuts are too costly for little or no gain.

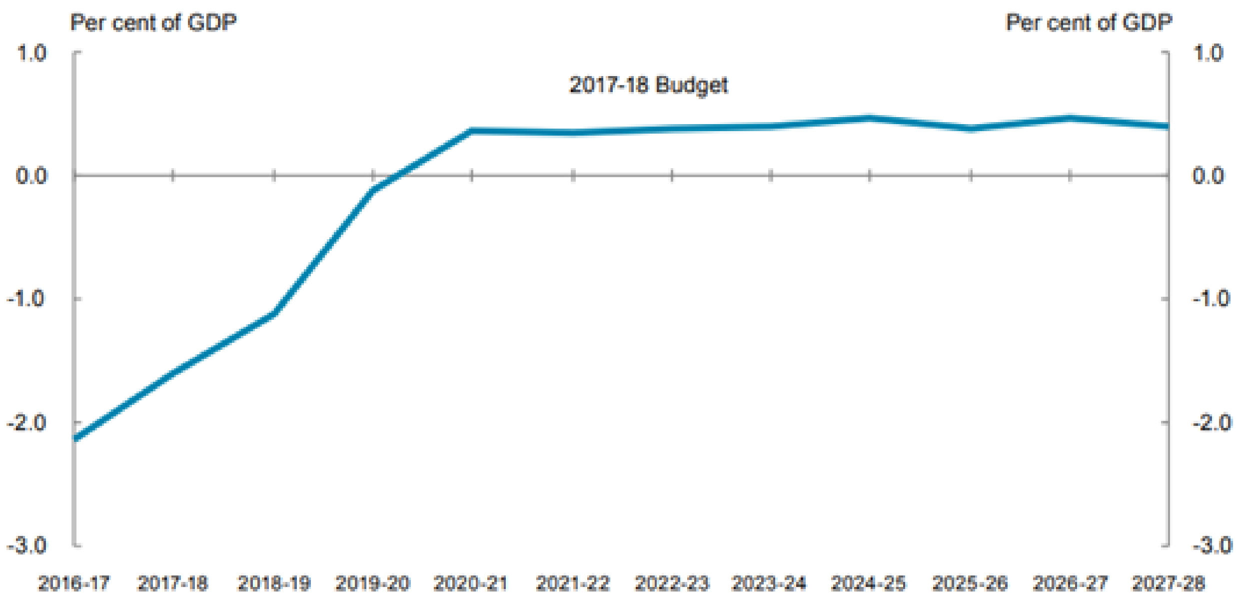
Even the Treasury's modelling of the impact of the proposed company tax cuts indicates the benefits to households will be small (less than a 0.7% increase in spending power) and only be felt after a decade or two. Recent reports suggest an even lower one-off income gain in the long run of $150 per person on average. Many experts doubt that this will happen at all.

Genuine tax reform would improve equity and strengthen revenue, and it would make economic growth more sustainable by removing distortions in the tax system that get in the way of productive investment.

Genuine tax reform would close shelters and loopholes in the tax system which high income-earners and many companies have taken advantage of for years to minimise tax, rather than just cutting income taxes and depriving governments of future revenue streams. In any business tax reform package, tax breaks such as capital gains, negative gearing, depreciation allowances, deductions for mining exploration costs and fuel tax offsets, and the loopholes that still allow companies to shift profits overseas and the owners of private companies to avoid tax on their personal income, should all be on the table.

The Budget is in deficit and could be for some years yet.

Budget balance, as projected in the 2017 Budget



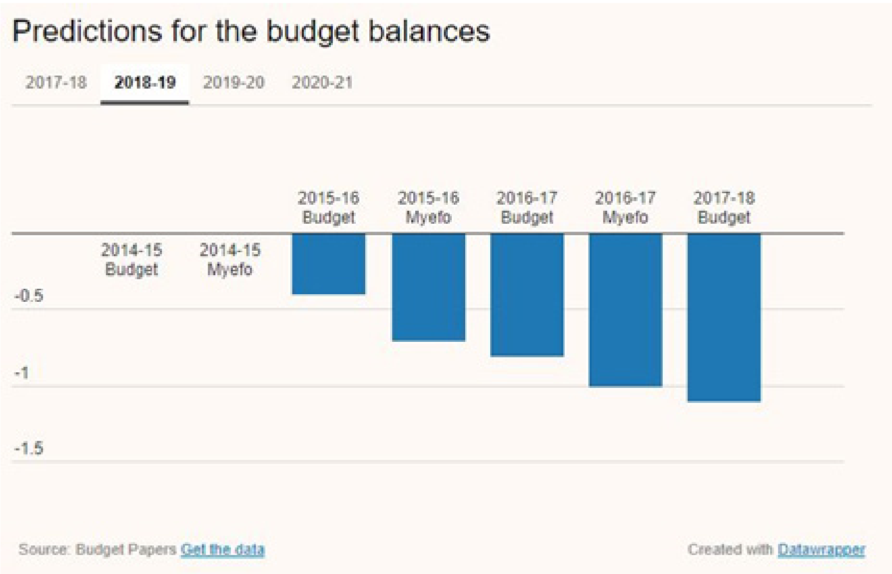
Source: Australian Treasury (2017): Federal Budget 2017-18, Budget Overview

The federal budget is in deficit and likely to remain so at least until 2020. For years now, governments have predicted surpluses and delivered deficits. They should promise tax cuts for companies or individuals only after a surplus is actually delivered.

The government predicts a budget surplus in 2020, but these predictions have been proven wrong many times in past budgets.

Last year's Budget (2016-17) predicted a surplus in 2020, but we've heard this before.

Budget predictions for surpluses or deficits since 2014



Source:Greg Jericho, The Guardian (May 2017) Federal budget 2017: the 10 graphs you need to see

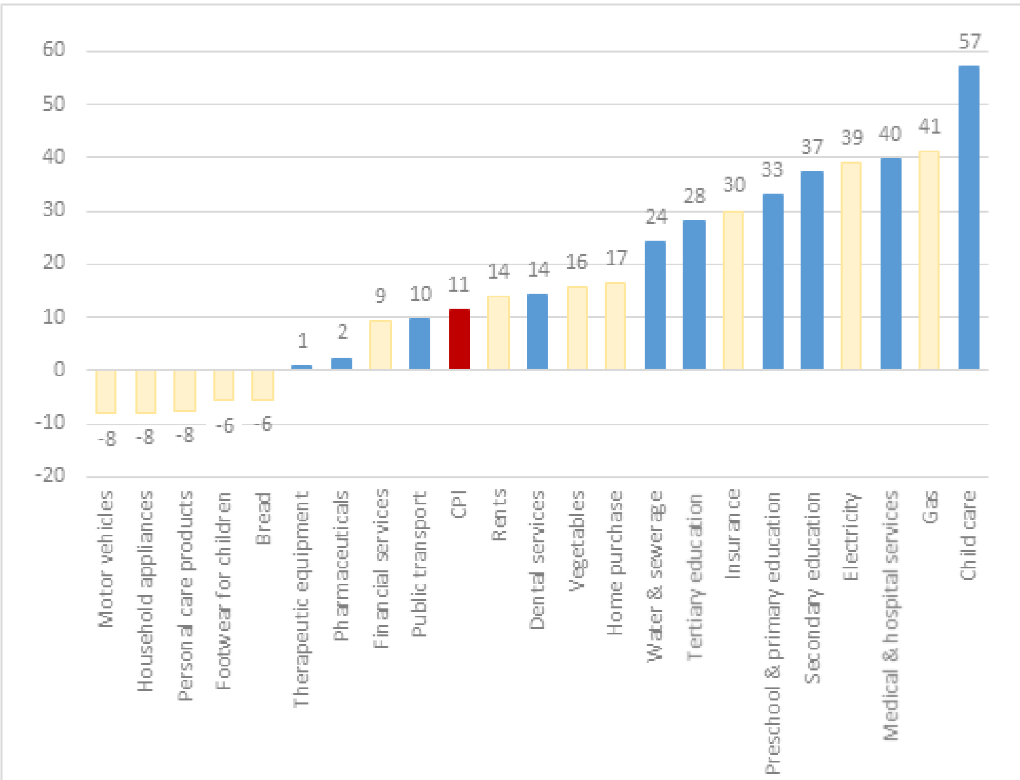
The company tax cuts are unfunded and costly.

The company tax cuts would cost $1.8 billion in 2019, rising to $14 billion in 2026 ($65 billion over 10 years). Unlike previous company tax cuts, the proposed cuts are not funded fully or even partly by removal of business tax breaks that are no longer fit for purpose.

We'll all pay for company tax cuts in reduced benefits and services, and higher user charges.

We have a choice: either cut company and personal tax now and face higher charges and longer waiting lists for health, aged care, dental care, education, and child care, or restore the budget so that essential services are guaranteed for all when we need them. Tax cuts now will be paid for by all of us, as we face higher user charges for essential services.

Some of the largest price increases over the last six years were in essential services funded by governments - price increases 2011-2017



Source: Consumer Price Index, Australia, average price increases over the last six years

At the same time that this tax cut legislation is tabled, the government wants to deny pensions to many new migrants and many Australian residents living overseas, cut payments to help with the costs of education for people on pensions, and has frozen family payment levels for families at risk of poverty.

Since the 2014 budget, Medicare rebates and family payments for low income families have been frozen, hospitals funding for the States has been cut, and $15 billion (over four years) was cut from vital community services including Aboriginal and Torres Strait Islander services, community legal centres and refuges for victims of domestic violence.

This comes at a time when the future cost of essential services such as health care and the NDIS is projected by the Parliamentary Budget Office to rise strongly.

Future governments will need more revenue to meet the growing cost of essential services and stem the rise in poverty.

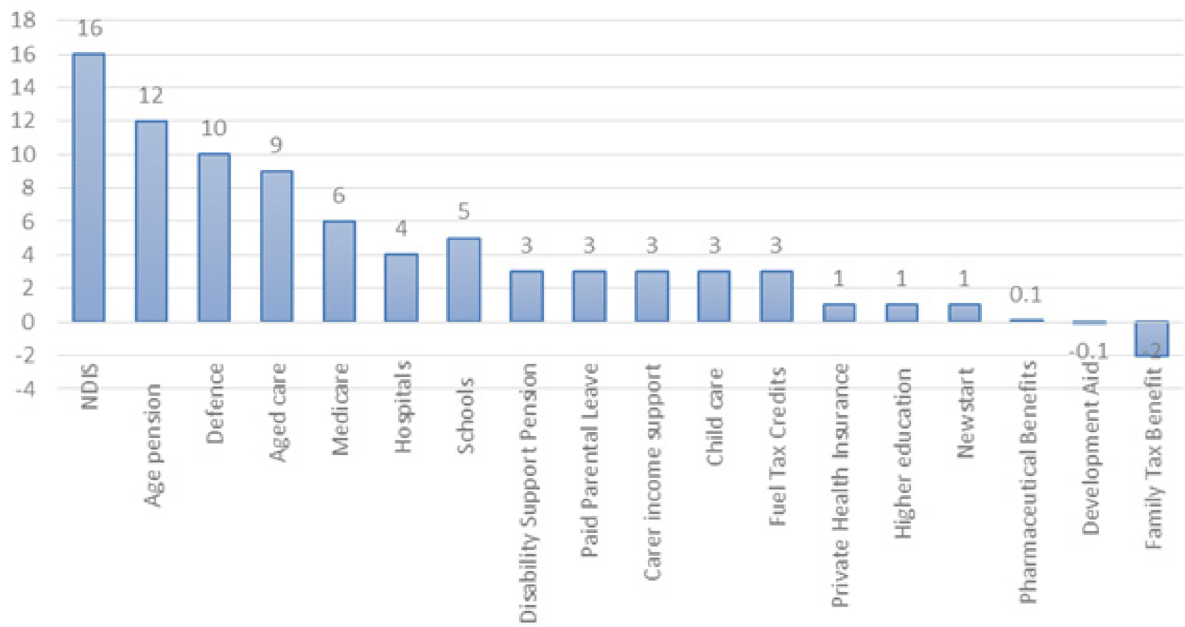
Essential services such as health, aged care and NDIS are the main drivers of growth in future government spending. We need governments to invest in these services as the population ages, and to close gaps such as in dental and mental health.

There is still much to be done to make sure our social security system is fit for purposes and prevents people from falling into poverty.

The economic benefits of a company tax cut, if any, would be small and take decades to realise.

The government argues a company tax cut is an investment in the future. Yet any gains in economic growth and income, if they happen at all, are likely to be small, and take a very long time to come.

Contributions to future growth in federal budget spending (%) 2013-2023



Source: Parliamentary Budget Office (2014) Projections of Government spending over the medium term

"There remain real questions about adequacy of the unemployment benefit, real questions about the affordability looking ahead for family payments, and real -questions about the complexity of our retirement income system, particularly the way the Age Pension interacts with super," Dr Henry, now the chairman of National Australia Bank, said. "I'm not sure on the right expression but it seems to me absurd, theatrically absurd, that we know we're going to have to raise taxes but we're having an argument about which taxes to cut."

Ken Henry, Chairman of National Australia Bank and former Treasury Secretary, The Australian, 2/4/18

Treasury estimates this company tax cut will lift household spending power by less than 0.7% over the long term (that is *10 to 20 years*). This is equivalent to a 0.43% wage rise in the long term. Further, recent reports suggest an even lower one-off income gain of $150 per person on average, in the long-term.

These outcomes depend on a complex sequence of events: more foreign investment in Australia, higher investment in equipment and other productive assets by the companies that receive this investment, more productive workplaces, and higher wages for workers. Unlike direct investment in productive infrastructure by governments, this chain could easily be broken at any point.

The impacts on investment by Australian companies are minimal, due to the dividend imputation system (which refunds to shareholders company tax paid in Australia).

Some expert commentators doubt whether company tax cuts will boost foreign investment in Australia at all. Others question whether it will flow through to wages in an environment where workers have very limited bargaining power. In any event, in any realistic scenario this would take many years.

There's still much to be done to make sure some companies (and high income earners sheltering their income in them) pay their share of income tax.

Unlike previous reductions in company tax rates, the proposed company tax cuts are unfunded:

- In 1999, company tax cuts were at least partly paid for by tightening up tax loopholes in the business tax system including non-commercial losses, loans to private company owners, trust losses, and the use of companies to shield 'personal services income' from tax.
- In 1988, company tax rate cuts were party paid for by removing 'accelerated depreciation allowances' for investment.

Any reform of business income tax worthy of the name would close off loopholes such the use of ''letterbox companies'' in Holland or Bermuda to shift income overseas, and borrowing funds from related entities at excessive interest rates to shift debt (which is deducted from company income) to Australia.

Many costly business tax concessions are no longer fit for purpose, such as deductions for exploration and fuel rebates for mining companies, the exemption from GST of banking services, and depreciation allowances that vary widely across different industries. These should be on the table in any proper reform of the company income tax system.

In addition, there is no evidence that company tax cuts for small companies are more beneficial than those for larger firms. Many of the beneficiaries of small company tax cuts are high income earners (for example professional practices) who use companies to avoid income tax on the earnings from their labour (by paying 30% instead of the 49% many would otherwise pay).[1] This tax shelter is not available to workers who earn their income directly from an employer. In many cases, these tax savings boost the personal income of people who are already well off, rather than growing their business or employing more people.

[1] The Government's company tax cut legislation had to be amended recently so that wealthy investors could not take advantage of the lower tax rate to shelter income from investments in private companies (as distinct from profits from an active business) from tax.