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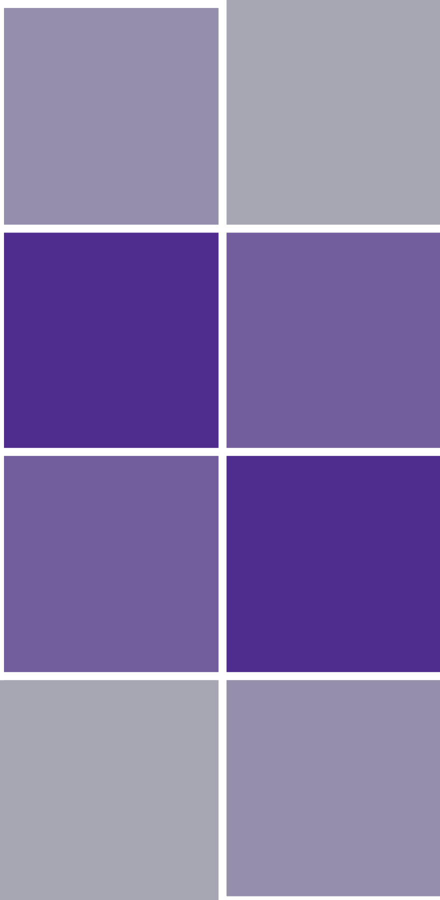

Business Tax Working Group

Final Report

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Thursday, 1 November 2012

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EXECUTIVE SUMMARY

1. The Business Tax Working Group (Working Group) was established following the Tax Forum in October 2011. The terms of reference ask the Working Group to make recommendations on how the business tax system could be improved to make the most of the challenges and opportunities arising from transformations in the broader economy, including the patchwork economy, and that aim to increase productivity while delivering relief to struggling businesses.

2. The Government asked the Working Group to prioritise consideration of a cut to the company tax rate accompanied by measures that fully offset the cost.[1] The Working Group released a Discussion Paper in August 2012 that sought views from stakeholders about some specific base broadening options to offset the cost to revenue of a cut to the company tax rate.

3. The Discussion Paper outlined the Working Group's view that a lower company tax rate would lead to greater investment in Australia, which would contribute to improved productivity and higher incomes for Australians. Australia is a relatively small, somewhat open economy that is increasingly integrated with international capital markets and reliant on highly mobile international capital to fund new investment. In this context, a lower statutory corporate tax rate would increase Australia's ability to attract foreign investment and increase the quantity of the capital stock for greater productivity. Over time, it would generally be expected that the economic benefits of greater productivity will be distributed between capital owners, labour and consumers, through higher profits and real wages and through lower prices.

4. The Discussion Paper also outlined a set of principles for business tax reform that have guided the Working Group's thinking and which would be relevant for future consideration of business taxation reform.

5. The Working Group's preliminary view was that a lower company tax rate funded by business tax base broadening could deliver net benefits to the economy. The Working Group's discussion paper canvassed base broadening options in the areas of interest deductibility, capital allowances and research and development expenditure, which, if adopted, could fund a company tax rate cut of two to three percentage points.

6. Following the release of the Discussion Paper, the Working Group met with 20 stakeholder groups and received more than 80 written submissions.

1 Hon. Julia Gillard MP, Prime Minister, Closing remarks at the Prime Minister's Economic Forum, 13 June 2012.

7. The Working Group also asked Treasury to undertake modelling of the potential long-run economic impacts of a lower company tax rate. The modelling, while preliminary, suggests that a one percentage point cut in the company tax rate, depending on how it was funded, could have a positive economic impact in the long run, raising GDP and real wages by around 0.2 per cent, and increasing household consumption. While modelling on the base broadening options was not completed and so could not be determinative for the Working Group's findings, the tentative and preliminary results reinforced some questions raised in consultations and submissions about whether, in theory, some combinations of base broadening and rate cutting could deliver a net economic benefit overall.

8. The Working Group has made a number of findings but is unable to recommend a revenue neutral package to lower the company tax rate. Several factors have been important to the Working Group in reaching this conclusion.

9. First, changes to depreciation arrangements could have a significant impact on the after-tax return on investment, particularly where there is a long lead time before income is produced (for instance, gas pipelines). Australia is currently experiencing an unprecedented level of investment, planned or underway, in the resources sector underpinned by strong demand from Asia. There are a number of significant investment decisions relating to resource projects that have recently been committed or will be considered in the near future. The sheer scale of capital investment in individual projects and the long lead times before production commences mean that changes made now to depreciation arrangements can have significant impacts on their expected returns.

10. Second, reductions in the company tax rate during the 1980s and 1990s were paid for by making the business tax base broader. As a consequence, the Working Group has found it difficult to identify support for measures that would further broaden the business tax base. As noted in the Discussion Paper, further broadening of the business tax base would involve a reversal of measures that have recently been enacted, the removal of longstanding taxation treatments that were not changed in previous base broadening exercises, or would significantly affect small groups of taxpayers.

11. Third, the economic benefits from a reduction in the company tax rate from the current rate are likely to be smaller than when the rate was much higher in the 1980s and 1990s, notwithstanding that capital may have become more mobile since then. The Working Group considers that a cut of two to three percentage points would be required to drive a significant investment response.

12. These factors have underpinned the lack of support in the business community for pursuing a lower rate/broader base reform of business taxation in Australia at this time. Many businesses that were particularly affected by the base broadening options asserted that they would have been worse off under the trade-offs canvassed. Further, some submissions questioned whether there would be a net benefit for the economy as a whole from a combination of some of the base broadening measures canvassed and a cut in the company tax rate of between one and three percentage points.

13. Nevertheless, the Working Group considers that there are benefits from a lower company tax rate and therefore Australia should have an ambition to continue the trend from the late 1980s to reduce its company tax rate as economic and fiscal circumstances and other budget priorities permit. A reduced rate would result in greater foreign investment flows into Australia by increasing the after-tax return on investment. Greater investment would enhance the capital to labour ratio, a process known as 'capital deepening', which could increase the marginal product of labour, resulting not only in higher economic growth but also higher wages in the long term.

14. This finding is consistent with the direction proposed by the Australia's Future Tax System (AFTS) Review, which recommended a tax mix switch and the introduction of improved charging arrangements for non-renewable resources as the precursor to a rate reduction.[2]

15. The Working Group's terms of reference also required it to consider the merits of a business expenditure tax, including an allowance for corporate equity (ACE). In its Discussion Paper, the Working Group set out its consideration of an ACE and expressed its initial view that an ACE should not be pursued in the short to medium term but may be worthy of further consideration and public debate in the longer term. The Working Group remains of this view following public consultation.

16. Tax reform should be seen as a continual process. The most recent conversation about tax reform in Australia began with the AFTS Review and continued at the Tax Forum last October. Following the Tax Forum, the Working Group was established to focus initially on the tax treatment of losses. The Working Group's recommendation to introduce limited loss carry-back, which has been adopted by the Government, will reduce the tax bias against riskier but worthwhile investments and support businesses adapting to changed economic conditions. This Report fulfils the second phase of the Working Group's task, which was to consider reducing the corporate tax rate further or moving to a business expenditure tax system, funded from within the business tax system.

17. The Working Group commends the principles for business tax reform it has identified as a useful framework that articulates the range of relevant considerations. The Working Group also supports the continuation of a consultative approach to business tax reform.

18. The Working Group would like to thank all of those organisations and individuals who made submissions and attended meetings during the Working Group's deliberations. The Working Group would also like to thank Alf Capito of Ernst & Young, Matt Cowgill of the Australian Council of Trade Unions, and Peter Crone of the Business Council of Australia, who assisted the Working Group. Finally, the Working Group would like to acknowledge the Treasury staff that assisted throughout this process.

2 AFTS Review (2009), *Final Report to the Treasurer*, Treasury, Canberra (recommendation 27).

Findings of the Business Tax Working Group

Finding 1: The Working Group believes there could be economic benefits associated with a cut in the company tax rate. A reduced rate would lead to greater investment in Australia in the longer term, which would contribute to improved productivity and higher wages for Australians.

Finding 2: The Working Group considers that a cut in the company tax rate of two to three percentage points would be needed to drive a significant investment response.

Finding 3: The Working Group has found that the business tax base is broader than it was in the 1980s and 1990s and significant savings are now more difficult to identify and reach consensus on.

Finding 4: The Working Group notes that there is considerable debate and uncertainty around the magnitude of the distortion associated with the remaining concessions in the business tax base, including concessions that promote important activity like investment in infrastructure and research and development.

Finding 5: The Working Group received feedback from many individual businesses asserting that they would be worse off as a result of the trade-offs canvassed in the Discussion Paper. Further, some submissions questioned whether there would be a net benefit for the economy as a whole from a combination of some of the base broadening measures canvassed and a cut in the company tax rate of between one and three percentage points. Overall, the Working Group has found there is a lack of agreement in the business community to make such a trade-off.

Finding 6: The Working Group considers that Australia should have an ambition to reduce its company tax rate as economic and fiscal circumstances permit. This would need to be considered against other budget priorities and should take into account the overall mix of business taxation.

Finding 7: The Working Group commends the principles for business tax reform it has identified as a useful framework that articulates the range of relevant considerations. The Working Group also supports the continuation of a consultative approach to business tax reform.

Finding 8: The Working Group considers that an ACE should not be pursued in the short to medium term but may be worthy of further consideration and public debate in the longer term.

CHAPTER 1: THE CASE FOR A CUT IN THE COMPANY TAX RATE

A principled approach to business tax reform

19. In considering how to approach business tax reform within its terms of reference, the Working Group developed the following set of principles:[3]

- **Revenue adequacy:** The business tax system should raise revenue that, together with other taxes, helps to pay for public services that the community relies upon.
- **Economic efficiency:** The business tax system should raise revenue in a way that minimises the effect of the tax system on business decisions except where this is needed to correct for market failures.
- **Competitiveness:** The business tax system should take into account Australia's integration with the global economy.
- **Distributional equity:** The business tax system and potential reforms should be understood in terms of where the final incidence falls among capital owners, workers and consumers.
- **Simplicity:** Business tax reform should be aimed at making the system as simple and as easy to comply with as possible, having regard to an often complex business environment, the need to ensure the integrity of the system and the costs and benefits of transitioning to any new rules.
- **New investment focus:** Business tax reform should generally focus on new investment.

20. The application of these principles underpinned the proposition put in the Discussion Paper that there were economic benefits from a lower company tax rate. The Working Group's further consideration of the issues, supported by the broad consultation undertaken by the Working Group, has confirmed its view.

A lower company tax rate to promote investment

21. A lower company tax rate has consistently been regarded as central to Australia's international competitiveness through its attractiveness as an investment destination.

22. As a result of base broadening business tax reform, the company tax rate has been reduced from 46 per cent in the mid-1980s to the current rate of 30 per cent. This included the outcomes from the Asprey Review and the Review of Business Taxation, which recommended the removal of a number of business tax concessions to fund a lower company tax rate. The AFTS Review recommended among other things, that the company tax rate be reduced to 25 per cent over the short to medium term with the timing subject to economic and fiscal circumstances and conditional on improved arrangements for charging for the use of non-renewable resources.[4] These reviews advocated a lower rate to encourage capital flows

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3 The full text of the principles is provided at Appendix A.

4 AFTS Review (2009), *Final Report to the Treasurer*, Treasury, Canberra (recommendation 27).

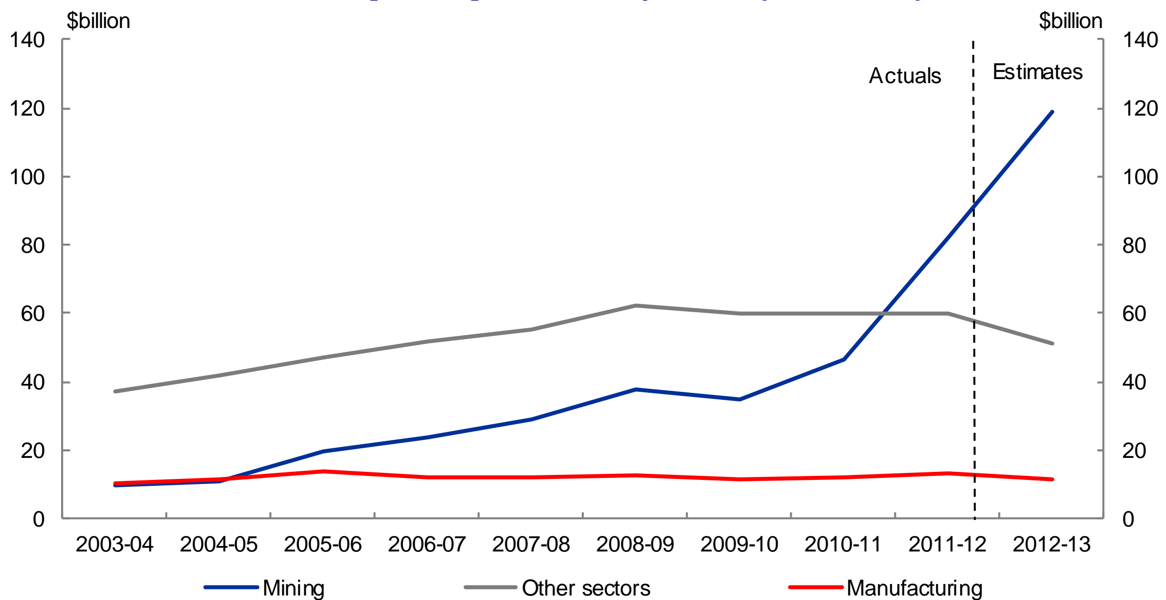
considered crucial for Australia's long-term investment prospects, economic growth and employment.[5]

23. This advocacy reflects Australia's dependence on international capital markets to respond to investment opportunities, a dependence that is unlikely to change in the future. Australia's capacity to compete effectively for these flows will be crucial to financing new investment in the long term. A company tax rate reduction could assist businesses to more easily fund investment opportunities through capital markets by lowering the pre-tax required rate of return for investors.

24. Australia currently has high levels of foreign direct investment and a substantial pipeline of investment, particularly in mining. Indeed, Australia is currently experiencing unprecedented levels of investment activity with new capital expenditure in the mining sector during 2010-11 being nearly four times the average annual expenditure of the past 30 years.[6]

25. As illustrated in Chart 1, however, this growth is not being experienced uniformly across the economy, with investment in the mining sector far exceeding new investment in manufacturing and other sectors. As the production capacity of Australia's mining sector becomes established the growth in mining sector investment is expected to moderate. As this occurs it will be increasingly important that other sectors within the economy are able to attract investment to maintain Australia's economic growth. A lower corporate tax rate could attract foreign investment in industries that are currently struggling with difficult domestic and international economic conditions as well as providing a better environment for investment in the longer term.

Chart 1: Capital Expenditures by sector (2003-2013)



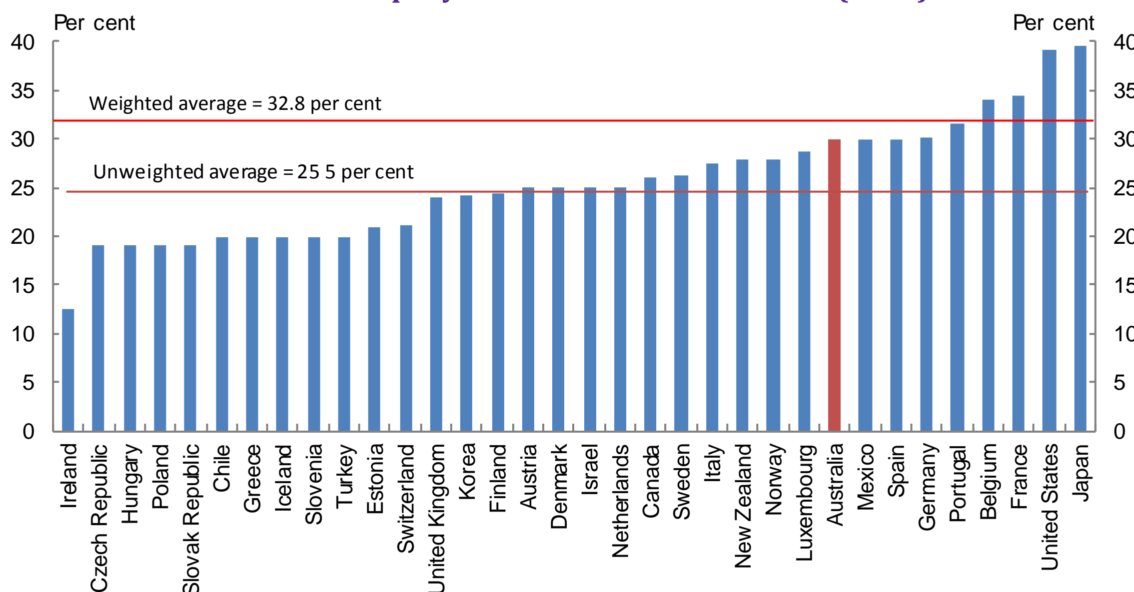
Source: ABS catalogue 5625.0

5 Review of Business Taxation (1999), *Review of Business Taxation: A Tax System Redesigned,* Treasury, Canberra, p 24. AFTS Review (2009), *Final Report to the Treasurer*, Treasury, Canberra, p 169.

6 New, R., Ball, A., Copeland, A. (2011), *Minerals and energy. Major development projects – April 2011 Listing*, Australian Bureau of Agricultural and Resource Economics and Sciences, Canberra.

26. Australia’s ability to attract investment is also affected by the company tax rates that apply in other countries. Australia’s company tax rate is below the OECD weighted average, but is above the unweighted average and higher than most other OECD countries (see Chart 2). This does not, however, take into account that different countries provide shareholder relief on dividend income in different ways, which can influence the overall level of tax paid on company profits across the entire tax system. For example, tax relief is provided for domestic investors under Australia’s dividend imputation system.

Chart 2: Company tax rates of OECD countries (2012)



Source: OECD tax database (2012) and weightings calculated using figures sourced from the IMF World Economic Outlook Database (2011).

27. In addition, many OECD countries have plans to further reduce their company tax rates. In recent budgets, the United Kingdom (UK) and Canadian governments reaffirmed plans for further corporate tax rate reductions. The UK corporate tax rate has been reduced from 26 to 24 per cent in 2012, and is expected to be further reduced to 23 per cent in 2013 and to 22 per cent in 2014. Canada, which has cut its federal rate from 18 to 16.5 per cent in 2011, will lower this further to 15 per cent. The Canadian Government has also called for provincial corporate tax rates to be reduced. The combined federal and provincial corporate tax rate in Canada ranges between 25 per cent and 31 per cent.

28. Theory suggests that a lower statutory rate and resulting lower effective average tax rate (EATR)[7] should enhance the incentives for multinational firms to invest in Australia. Statutory tax rates and EATRs have been found to be significant determinants of investors’ choices of location for investments.[8] Increased economic globalisation has enhanced the prominence of location choice in multinationals’ decision making processes. The AFTS Review cited evidence that on average a one percentage point increase in the rate of tax would result in a decrease in foreign direct investment of 3.72 per cent.[9] To the extent that a firm’s value is tied to the value

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7 EATRs measure the proportion of an investment that is paid in tax. EATRs affect location decisions such as where to locate investment and where to locate profits.

8 Altshuler, R., Grubert, H., & Newlon, T. (2000), ‘Has U.S. Investment Abroad Become More Sensitive to Tax Rates?’, *International Taxation and Multinational Activity,* National Bureau of Economic Research. Devereux, M (2003), ‘Evaluating Tax Policy for Location Decisions’, *International tax and public finance,* vol. 10, no. 2.

9 AFTS Review (2008), *Architecture of Australia’s tax and transfer system*, Treasury, Canberra, p 296.

of its intellectual property, a firm is able to minimise its overall tax liability by basing such intangible assets in a country with a low statutory tax rate. Accordingly, reductions in the Australian corporate tax rate can affect marginal location choices.

29. Compared to purely domestic entities, multinational firms enjoy greater freedom and range of choice in their decision of where to locate production, making them more responsive to corporate tax rates. Of course other factors also contribute to a country's attractiveness as an investment destination, such as access to materials and the quality of the labour force.

30. A lower statutory company tax rate could also make Australia less susceptible to profit shifting by multinationals. Changes in how business is undertaken have increased the ability of multinationals to shift profits to countries that offer the most favourable tax regimes. Profit shifting practices have been spurred by the increasing share of economic activity for which multinational corporations are responsible.

31. Comparisons of statutory tax rates do not, however, say anything about the effective tax rate that the investment bears because tax bases also differ considerably between countries. As rates have been cut, bases have been broadened. In many cases, countries have opted to reduce or eliminate accelerated depreciation allowances in order to more closely align allowances with economic rates of depreciation. Between 1982 and 2005, 11 OECD countries reduced their tax depreciation rates for investment in plant and machinery. Allowances for intangibles, plant and machinery and especially buildings have all become less generous in the past two decades. Some countries have also funded tax rate cuts by abolishing their dividend imputation systems.

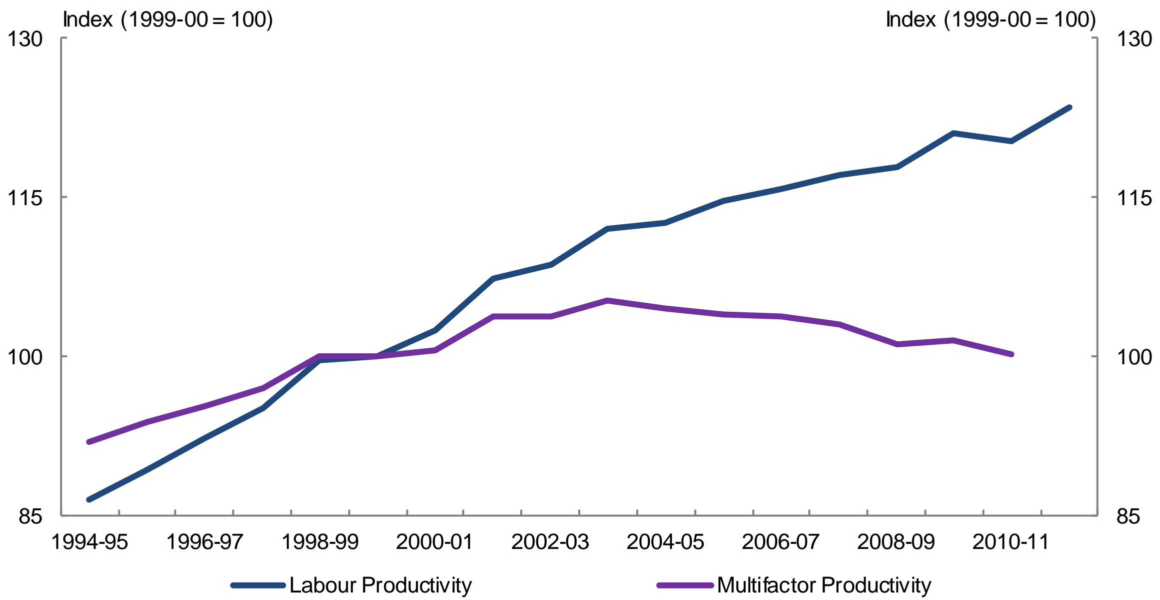
32. In considering the rate of company tax that should apply, attention also needs to be paid to the key function of tax, which is to raise revenue. The business tax system should contribute to the revenue that is necessary to pay for the public services that the Australian community relies upon. The competitiveness of Australia's company tax rate therefore needs to be considered alongside its ability to contribute to revenue adequacy. Considerations such as the level of complexity of the tax system and the efficiency of the tax administration will also play a part.

The company tax rate and productivity

33. A lower company tax rate is one way that business tax reform could contribute to an improvement in the economy's productivity performance, which is a key to facilitating continued economic growth.

34. While Australia's productivity levels are high, lifting our productivity performance will be a key driver of future prosperity. In particular, Australia's future economic growth will increasingly depend on its ability to improve how labour and capital are combined in production. Chart 3 illustrates how Australia's multifactor productivity, which measures how well the economy as a whole is combining capital and labour into production, has been stagnating over the past 15 years.

Chart 3: Market sector productivity in Australia (1994-2012)



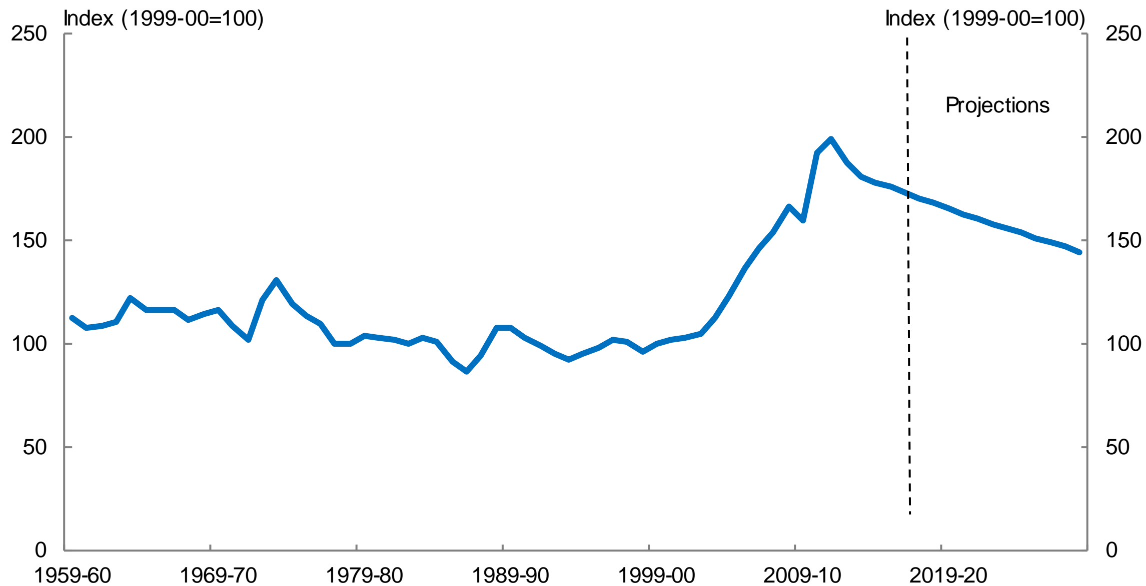
Source: Dolman & Gruen (2012) and ABS Cat. 5206.0[10]

35. Australia's weak multifactor productivity growth has been exacerbated by the pressures exerted on those firms that find themselves in the 'slow lane' of the two-speed economy, however, overcoming this issue is of even greater importance when considering that the current high terms of trade and rate of investment in mining industries are moderating.

36. The growth of Asia has significantly increased the worldwide demand for natural resources and fuelled the investment in the mining and mining-related sectors of the Australian economy. This has created considerable adjustment pressures for Australian exporters in non-mining sectors, such as manufacturing, tourism and education. The high terms of trade and corresponding high Australian dollar (see Chart 4) have reduced the international competitiveness of these sectors by increasing the price that other countries pay for our goods and services. These factors are contributing to Australia's patchwork economy — with growth unevenly distributed across all sectors.

10 Data are for 16 market sector industries. Data are not available for 2011-12 multifactor productivity.

Chart 4: Australia's terms of trade



Source: Dolman & Gruen (2012)

37. A lower company tax rate can improve productivity by increasing the level of capital in the economy. By reducing effective marginal tax rates (EMTRs),[11] a lower company tax rate can reduce a project's hurdle rate of return. As a result, more investments will be undertaken. As the quantity of investment in the economy increases, there is an increased level of capital in the economy. Greater quantities of capital will enhance the marginal productivity of labour, resulting in an increase in productivity, economic growth and incomes.

38. A reduction in the company tax rate would also reduce distortions in the tax system relating to financing decisions and depreciation. The tax system favours debt over equity financing by providing a deduction for interest payments on debt but not a return for shareholders on equity. In addition, the tax system does not perfectly align tax depreciation with economic depreciation (such as through accelerated depreciation provisions and the immediate expensing of some intangibles), which can distort business investment choices. Reducing the company tax rate would reduce the extent of both these distortions and result in a more efficient allocation of capital.

39. Estimates of the marginal welfare loss from different taxes suggest that company tax at its current rate is a relatively inefficient vehicle to use as an incremental source of tax revenue.[12]

40. The benefits of a lower corporate tax rate would be dynamic rather than static. In the short run, a lower corporate tax rate should predominately benefit capital owners in the form of enhanced levels of profitability.[13] Such higher rates of return may be reinvested within the business or distributed to shareholders. However, a reduction in the company income tax rate would also increase the after-tax return on investment, encouraging more investment and thereby enhancing the capital to labour ratio within the economy. This process of 'capital deepening' could increase the marginal product of labour, resulting not only in higher

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11 EMTRs measure the effect of tax on the return to an investment that just breaks even or covers all of its economic costs. EMTRs affect a business's choice of how much to invest in a project.

12 AFTS Review (2009), *Final Report to the Treasurer*, Treasury, Canberra, p 13.

13 More specifically, the short-term beneficiaries of a rate cut would be non-resident shareholders, as any gain to domestic shareholders would be offset through the dividend imputation system.

economic growth but also higher wages in the long term.[14] In the long run some of the incidence of a lower company tax rate would also be captured by capital owners earning location-specific profits, such as those within the resources industry.[15] For other non-resident investors the investment induced by the lower company tax will in the long run drive down the pre-tax return so that these investors end up with about the same after-tax return.

41. Consistent with the principle of revenue adequacy, the business tax system should raise revenue that, together with other taxes, helps pay for public services that the community relies on, including investment in infrastructure, research and education, which can also support productivity.

Economic impact of cutting the company tax rate

42. Treasury modelling commissioned by the Working Group indicates that a reduction in the statutory company tax rate from 30 to 29 per cent would increase gross domestic product (GDP) and household consumption in the long run. Further details of the model and key assumptions can be found at Appendix B.

43. Importantly, the modelling assumes that the cut in the company tax rate is offset by a reduction in lump sum transfers to households to keep the government budget balanced. This is a standard technical assumption. The benefit of potential policy reform packages would, of course, depend upon how the rate reduction is funded.

44. The modelling suggests that a company tax cut of this size would increase the level of GDP by 0.2 per cent compared with what would otherwise be the case.[16] This increase in GDP is driven mainly by greater foreign investment flows into Australia to fund additional projects that are made viable by the reduction in the tax rate. Under reasonable assumptions in the model, additional capital investment increases the capital stock by 0.3 per cent.

45. The modelling also suggests that Australian workers benefit from the company tax cut in the long run. The productivity of labour increases with the increase in the size of the capital stock and this flows through to an increase in after-tax real wages of 0.2 per cent and a small increase in labour supply of around 0.1 per cent. Overall, the modelling shows that cutting the company tax rate can deliver an improvement in consumption by Australian households of around 0.05 per cent.[17]

46. As noted above, the Working Group considers that a cut in the company tax rate of two to three percentage points would be needed to drive a significant investment response. The impact of a cut of two (or three) percentage points would be expected to be slightly less than double (or triple) the impact from a one percentage point cut.

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14 AFTS Review (2009), *Australia's Future Tax System,* Treasury, Canberra, p 166.

15 Henry, K. (2009), *A Tax System for Australia in the Global Economy*, speech to the Australian Business Tax Reform in Retrospect and Prospect colloquium, Sydney, 23 February 2009.

16 A reasonable working assumption may be that half of the change in the economy will occur within approximately seven years, and the adjustment will be largely complete within 20 years.

17 Consumption in this context is a measure of the volume of consumption of goods and services as well as leisure time enjoyed by Australian households.

CHAPTER 2: CONSIDERATION OF A LOWER COMPANY TAX RATE AND A BROADER BUSINESS TAX BASE

47. The Working Group received feedback from many businesses questioning whether net benefits would arise for those businesses from lowering the company tax rate funded by the options canvassed in the Discussion Paper. Overall, the Working Group has found there is a lack of agreement in the business community to make such a trade-off.[18]

48. While there have been a number of business tax reforms in Australia in recent decades that have traded off a lower company tax rate for a broader tax base, the Working Group has identified three key factors that have resulted in such a trade-off not being seen as beneficial at this time:

- the level of uncertainty facing the business community as the economy is undergoing structural change;
- previous reductions in the company tax rate were funded by making the business tax base broader, such that there would be lesser benefits associated with removing the remaining concessions (relative to a comprehensive business income tax base); and
- the already lower rate of company tax compared with earlier business tax reform exercises, which means that the benefits associated with a further cut would not be as large as those achieved previously.

The economy is undergoing structural change

49. The Working Group's consideration of longer term reforms of the business tax system has come at a time of significant change and uncertainty for the domestic and international economy. These circumstances present both significant opportunities and profound challenges for Australian businesses.

50. Despite difficult international economic conditions, Australia's economy remains strong. However, economic activity is uneven, with mining and mining-related sectors experiencing relatively strong growth, while some sectors remain under pressure from the sustained high dollar, sector-specific structural changes and turbulence in the global economy.

51. The current economic environment makes it particularly important for Australia to ensure that businesses are well positioned to take advantage of emerging investment opportunities and are prepared to adapt to the changing economic conditions. Australia's future economic growth prospects are dependent on our ability to encourage new investment and enhance productivity growth within challenging international and domestic conditions.

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18 Details about the Working Group and its activities are provided at Appendix C. Details of submissions received in response to the Discussion Paper are provided at Appendix D.

52. In response to the adjustment pressures being driven by the high terms of trade, businesses across the economy are adopting new business models, sourcing new plant and equipment, investing in their workforce and exploring new markets and product lines. Businesses are also seeking innovative ways to adapt to ongoing changes in technology, consumer preferences and market conditions. New investment is needed to meet these challenges.

53. The Working Group's earlier recommendation to introduce limited loss carry-back, now being implemented by the Government, was proposed in this context. Loss-carry back will assist businesses with tight cash flows to internally fund the new investments they require for them to adapt to changing market conditions. Investments will be made with a greater expectation that a business will receive tax refunds if losses are incurred in future years. This will reduce the tax bias against riskier but worthwhile investment and support businesses adapting to changed economic conditions.

54. In a similar vein, the Working Group recommended that further analysis be undertaken with a view to developing a model for reforming the same business test (SBT). The Working Group remains concerned that the SBT too narrowly prescribes the range of activities that a company can engage in without risking forfeiture of its losses. Further, its application varies with a taxpayer's facts and circumstances making it difficult to determine prospectively whether or not the SBT is likely to be satisfied.

55. The treatment of tax losses will continue to play a role in determining the tax burden on new investment into the future. This report should therefore be read in conjunction with the Working Group's recommendations from its *Final report on the tax treatment of losses*.

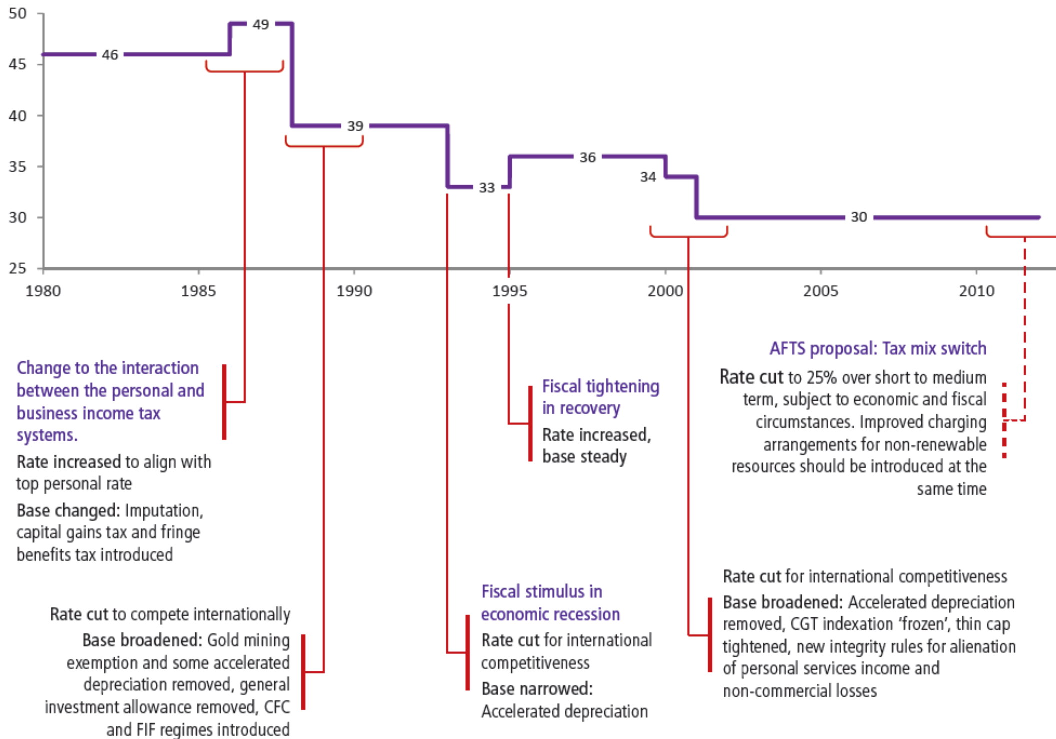
56. There is also a significant pipeline of resource investments either recently committed or under consideration that have been initiated under the current taxation arrangements. Any transitional rules that quarantine the impact on existing investments would mean that the revenue savings resulting from a taxation change may take some years to flow.

57. In the context of the substantial pipeline of capital investment, adjustment pressures on many sectors and continued uncertainty in the international economy, changes to the business tax base (such as less generous rates of depreciation) would increase effective marginal tax rates on some marginal investments and could create uncertainty in the fiscal environment, which could harm investment prospects. In contrast, a lower company tax rate would assist businesses to invest in plant and equipment, innovate and adopt improved business models. This would improve business' ability to adapt to changing economic and market conditions, which is essential for future economic growth.

58. In weighing up these contrasting impacts, it was clear to the Working Group that there was not agreement in the business community to broaden the business tax base to fund a cut in the company tax rate at this time.

Australia has a broad business tax base

Chart 5: Company tax rates in Australia (1980-present)



Source: Business Tax Working Group Consultation Guide (2012)

59. Reductions in the company tax rate during the 1980s and 1990s were paid for by making the company tax system broader, such as introducing capital gains tax and fringe benefits tax, applying income tax to gold, and removing most accelerated depreciation.

60. As a result of these previous reforms, the Working Group has found it more difficult to identify ways to broaden the business tax base further. There is considerable debate and uncertainty around the magnitude of the distortion of the remaining concessions, including concessions that promote important activity like investment in infrastructure and research and development.

61. The Working Group consultation revealed that there is not agreement in the business community to pay for a company tax cut from within the business tax system. The base broadening options would have involved a reversal of measures that have recently been enacted, the removal of longstanding taxation treatments that were not changed in previous base broadening exercises, or would significantly affect small groups of taxpayers. Any cut to the company tax rate would, however, flow to all companies, including those relatively unaffected by the base broadening measures, including those in non-capital intensive service sectors.

Australia has a lower company tax rate than previously

62. The third key factor the Working Group has considered is that the economic benefits from a reduction in the company tax rate are less the lower is that rate.

63. As noted above, a lower company tax rate can reduce the deterrent effect of company tax on marginal investments and the extent to which departures from a uniform tax base distort business investment choices. However, as a rule of thumb, the efficiency cost of a tax relates to the square of the tax rate.[19] This means that as the company tax rate is lowered, the additional efficiency gain from a further reduction is also lowered.

64. The company tax rate at 30 per cent is considerably lower than it was in the 1980s and 1990s. As a result, the expected gain from reducing the rate further is likely to be less than previous reforms, notwithstanding that capital may have become more responsive to tax rates in the meantime.

Economic impact of a lower rate and broader base

65. As outlined in the Chapter 1, Treasury modelling indicates that a lower company tax rate could boost the level of GDP and household consumption. This result occurs because Australia is a relatively small open economy with net capital imports, and faces a highly elastic supply of capital. Therefore a lower tax rate on the income earned on foreign capital would increase aggregate investment, which in turn would increase productivity and real wages.

66. While the economic modelling of the potential impacts of broadening the business tax base and lowering the company tax rate was not completed, in theory it may be possible for specific options to have an overall negative impact on GDP and household consumption. If the price responsiveness of the supply of international capital to the removal of existing tax concessions is greater than the price responsiveness of capital to a reduction in the company tax rate, then overall investment, productivity and wages could fall in response to a lower rate, broader base package.

67. For example, a company tax rate cut funded by a reduction in the diminishing value method rate of depreciation to 150 per cent (from 200 per cent) would likely benefit highly profitable projects, but theoretically may not increase investment if these projects would go ahead regardless. In contrast, more marginal projects may receive less benefit from a rate cut than the cost they incur from lower depreciation allowances, causing some to become unviable and reducing overall investment. Therefore, it is possible that some packages may not increase GDP or household consumption.

68. This is not to suggest that there would be benefits from introducing new specific concessions, which apart from likely efficiency costs, would raise administrative and political economy concerns that would need to be evaluated.

19 Harberger, A. (1964), 'Taxation, Resource Allocation and Welfare', NBER chapters in: *The role of direct and indirect taxes in the Federal Reserve system*, National Bureau of Economic Research, pp 25-80.

CHAPTER 3: ALLOWANCE FOR CORPORATE EQUITY

69. The Working Group's terms of reference require it to consider the merits of a business expenditure tax, including an allowance for corporate equity (ACE). The Working Group undertook its consideration through an examination of the economic literature, consultation with overseas academics and an examination of how an ACE would operate in the Australian taxation system. These considerations were set out in the Discussion Paper.

70. The Working Group also considered international experience with the ACE. There has been limited international experience in implementing an ACE to date and no experience in implementing an ACE in a system that provides full dividend imputation. An ACE's interaction with the imputation system and how an equity base may be defined are just some of the design challenges that would need to be overcome.

71. Further, full implementation of an ACE would not be possible within the revenue neutral constraint imposed by the Working Group's terms of reference with the base broadening options identified in this paper. The Working Group would not advocate increasing the corporate tax rate to fund the implementation of an ACE. Recent studies and reviews that have considered an ACE have concluded that the introduction of an ACE paid for through a higher corporate tax rate may be counterproductive.

72. For these reasons, the Working Group considers that an ACE should not be pursued in the short to medium term but may be worthy of further consideration and public debate in the longer term.

CHAPTER 4: FINDINGS OF THE BUSINESS TAX WORKING GROUP

73. The Working Group has considered whether Australia should pursue a cut in the company tax rate accompanied by measures that fully offset the cost by broadening the business tax base. The Working Group believes that a lower company tax rate would encourage new investment and enhance productivity across the economy, supporting Australia's growth prospects and living standards. However, the Working Group has found that there is a lack of agreement in the business community to trade off the base broadening options identified in the Discussion Paper for a cut in the company tax rate.

74. In coming to the view that a cut in the company tax rate funded from within the business tax system should not be pursued at this time, the Working Group has developed and applied a number of design principles and has made its judgments in the context of significant structural shifts in the domestic and world economy, and against the backdrop of an uncertain global economic outlook. The Working Group and stakeholders also identified risks associated with pursuing proposals to offset the costs of a company tax rate cut when the potential revenue saving from those proposals are uncertain.

75. While the Working Group is not able to recommend a revenue neutral package to lower the company tax rate, it considers that Australia should have an ambition to reduce its company tax rate as economic and fiscal circumstances permit. Of course, any future proposal in this area will need to be considered against other budget priorities.

Findings of the Business Tax Working Group

Finding 1: The Working Group believes there could be economic benefits associated with a cut in the company tax rate. A reduced rate would lead to greater investment in Australia in the longer term, which would contribute to improved productivity and higher wages for Australians.

Finding 2: The Working Group considers that a cut in the company tax rate of two to three percentage points would be needed to drive a significant investment response.

Finding 3: The Working Group has found that the business tax base is broader than it was in the 1980s and 1990s and significant savings are now more difficult to identify and reach consensus on.

Finding 4: The Working Group notes that there is considerable debate and uncertainty around the magnitude of the distortion associated with the remaining concessions in the business tax base, including concessions that promote important activity like investment in infrastructure and research and development.

Finding 5: The Working Group received feedback from many individual businesses asserting that they would be worse off as a result of the trade-offs canvassed in the Discussion Paper. Further, some submissions questioned whether there would be a net benefit for the economy as a whole from a combination of some of the base broadening measures canvassed and a cut in the company tax rate of between one and three percentage points. Overall, the Working Group has found there is a lack of agreement in the business community to make such a trade-off.

Finding 6: The Working Group considers that Australia should have an ambition to reduce its company tax rate as economic and fiscal circumstances permit. This would need to be considered against other budget priorities and should take into account the overall mix of business taxation.

Finding 7: The Working Group commends the principles for business tax reform it has identified as a useful framework that articulates the range of relevant considerations. The Working Group also supports the continuation of a consultative approach to business tax reform.

Finding 8: The Working Group considers that an ACE should not be pursued in the short to medium term but may be worthy of further consideration and public debate in the longer term.

APPENDIX A — PRINCIPLES FOR BUSINESS TAX REFORM

Policies that remove impediments in the tax system to new investment will enhance productivity across the economy, supporting Australia's growth prospects and living standards. The Working Group's principles are intended as a framework for thinking about business tax reform in this context. Each principle is accompanied by explanatory text to guide its application.

The application of these principles will necessarily involve judgements about how a particular package of reforms performs against an individual principle and against the framework as a whole. In seeking to reform the tax system, principles can conflict and there will necessarily be trade-offs that need to be made in getting the balance right. A critical aspect of these trade-offs is that they be made transparently.

The terms of reference require the Working Group to have regard to the Australia's Future Tax System (AFTS) Review. In its final report to the Treasurer, the AFTS Review set out some core design principles for the tax–transfer system: equity; efficiency; simplicity; sustainability and policy consistency. Using these principles as a foundation, the Working Group has developed its principles for business tax reform.

1: Revenue adequacy: The business tax system should raise revenue that, together with other taxes, helps to pay for public services that the community relies upon.

- The primary function of any tax system is to raise revenue to fund the provision of goods and services by the government. The Australian community will continue to demand efficient, responsive and relevant public services, funded by taxes.

- Business tax revenues make a contribution towards funding these goods and services. This will continue to be the case, regardless of the particular reform options adopted.

- The integrity of the system is important in securing predictable adequacy of revenue.

2: Economic efficiency: The business tax system should raise revenue in a way that minimises the effect of the tax system on business decisions, except where this is needed to correct for market failures.

- By distorting investment and production decisions, the business tax system can deter investment and lead to an inefficient allocation of resources within the economy. In this way, it can detract from Australia's productivity performance and future living standards.

- Business tax should be applied in a way that minimises its impact on business decision making. It can be useful to think about the impact of business tax on the following set of decisions:

  - What to invest in?
  - Where to invest?
  - How much to invest?
  - How to finance investment?
  - The organisational form through which to undertake the investment?

  - Where to record profits arising from investment?
  - How to distribute income?
  - When to invest?

- Efficiency gains arising from business tax reform will be realised as a result of changes in business decisions which in turn, over time, change prices and quantities. However, different tax reform proposals will affect these decision margins in different ways. All feasible options will retain some form of distortion, but the aggregate impact of some options will be smaller than others. Assessing these impacts is challenging, given the complexity of the overall tax system and the range of factors that influence business behaviour.

- Efficiency enhancing reforms are more likely to be successfully implemented and sustainable if the rationale for change is clear and well understood by businesses and the public.

- The tax system is one tool which the Government has at its disposal to correct for the failure of the market to take account of positive and negative spillovers or externalities. Tax concessions can be used to encourage socially beneficial activities in which there would otherwise be underinvestment. Similarly, tax can discourage activities that impose a cost on the community as a whole.

3: Distributional equity: The business tax system and potential reforms should be understood in terms of where the final incidence falls among capital owners, workers and consumers.

- The size and openness of the Australian economy and the existence of economic rents suggest that in the long run most of the burden of Australia's company tax is probably borne by labour and consumers, but with some of the incidence falling on capital owners earning resource and other immobile rents.

- In the short run, it is likely that a larger share of the incidence of a reduction in Australia's company tax rate (relative to rates applying elsewhere) would be captured by capital owners.

- The company tax system raises revenue by acting as a final tax on foreign investors and, as a result of imputation, as a withholding tax on domestic investors. Proposed reforms need to be understood in terms of their impact on after-tax returns to different investors.

- The interaction of business tax with elements of the broader tax-transfer system such as capital gains tax and personal income tax must be understood. Regard needs to be given to the distribution of share ownership among resident households and superannuation funds and non-residents and the different tax treatments of their income from companies.

4: Competitiveness: The business tax system should take into account Australia's integration with the global economy.

- Australia has long been a net capital importing country, and will continue to be so, making it important that our business tax settings take into account the potential for the tax system to discourage investment by increasing the cost of foreign capital.

- The growing importance of outbound investment means the competitive position of Australian business offshore is an important consideration for Australia's business tax policy.
- The competitiveness of Australia's business tax arrangements also needs to be considered in the context of the range of other, non-tax factors that make Australia a good place to do business and invest.

5: Simplicity: Business tax reform should be aimed at making the system as simple and as easy to comply with as possible, having regard to an often complex business environment, the need to ensure the integrity of the system and the costs and benefits of transitioning to any new rules.

- Businesses are more likely to make efficient decisions, and respond as intended to policy signals, if the business tax system is simple to understand and the processes necessary to comply are not unduly complex.
- Simplicity can deliver productivity gains by allowing scarce resources to be reallocated away from tax compliance and administration.
- However, the business tax system also needs to be able to cope with sophisticated business transactions and arrangements.
- That said, complexity can undermine the integrity of the business tax system. The ongoing integrity of the business tax system is essential to its role in collecting revenue.
- Complexity in the business tax system can also arise from interactions with other parts of the broader tax system.
- Even where a particular reform may ultimately lead to a more efficient and less complex system in the long run, these gains should be assessed against the costs of transition in the short to medium term.

6: New investment focus: Business tax reform should generally focus on new investment.

- Generally, business tax reforms are forward-looking. However, retrospective changes will sometimes be desirable. It is important that any reform proposals include a clear pathway from current arrangements to the desired reform destination. Transitional arrangements can also raise issues of fairness and system design.
- Changing the tax outcome of existing business ventures may deliver a windfall gain or loss to taxpayers. This needs to be weighed against any potential impact that tax reform may have on the revenue adequacy, efficiency and simplicity of the tax system.
- Difficult decisions need to be made about the appropriate commencement of business tax reforms, taking account of the potential impacts resulting from these trade-offs.

APPENDIX B — BUSINESS TAX MODELLING

The Business Tax Working Group's terms of reference ask it to provide specific analysis of business tax reform options that relieve the taxation on new investment, including impacts on national income. To achieve this, the Working Group requested Treasury undertake modelling to provide an assessment of the potential long-run economic impacts of company tax reform.

The modelling uses a computable general equilibrium approach. Computable general equilibrium models mathematically represent how the economy operates and how the behaviour of firms and households change in response to incentives. They are useful for exploring the economic impacts of business tax because they trace through linkages between factor markets and product markets to allow an estimate of where the costs of the tax system are borne, which can be very different from where taxes are levied. While these models have their limitations, they provide an integrated framework for analysis, based in economic theory and using the best available economic and taxation data.

The analysis is undertaken using the Independent CGE Model, Independent Economics' computable general equilibrium model. It is a comparative static model of the Australian economy. Treasury and Independent Economics worked together to extend and calibrate the model to make it suitable for modelling the business tax system.[20] The model has been designed to represent economic effects of the company tax system on: the size of the capital stock in each industry; the mix of capital types; labour force participation; the location of multinational profits; and the location of multinational firm-specific assets, such as intellectual property.

The modelling suggests that a company tax cut from 30 to 29 per cent would increase the level of GDP by 0.2 per cent compared with what would otherwise be the case. This increase in GDP is driven mainly by greater foreign investment flows into Australia to fund additional projects that are made viable by the reduction in the tax rate. Under reasonable assumptions in the model, additional capital investment increases the capital stock by 0.3 per cent.

The modelling also suggests that Australian workers benefit from the company tax cut in the long run. The productivity of labour increases with the increase in the size of the capital stock and this flows through to an increase in after-tax real wages of 0.2 per cent and a small increase in labour supply of around 0.1 per cent. Overall, the modelling shows that cutting the company tax rate can deliver an improvement in consumption by Australian households of around 0.05 per cent.[21]

As noted above, the Working Group considers that a cut in the company tax rate of two to three percentage points would be needed to drive a significant investment response. The impact of a cut of two (or three) percentage points would be expected to be slightly less than double (or triple) the impact from a one percentage point cut. . The modelling results represent long-run changes to the economy. They provide an analysis of the change in the economy from now to a time in the future when capital and labour markets have fully adjusted to policy changes. A reasonable working

20 Independent Economics designed the overall economic structure of the model; Treasury calibrated the model to match the business tax data and provided a range of parameters, such as the profit shifting elasticity and the share of rents that are firm-specific.

21 Consumption in this context is a measure of the volume of consumption of goods and services as well as leisure time enjoyed by Australian households.

assumption may be that half of the change in the economy will occur within approximately seven years, and the adjustment will be largely complete within 20 years.[22]

Key features of the model include the following.

- **Up-to-date database.** The model is designed to represent the 2011-12 Australian economy, based on an uprated version of the Australian Bureau of Statistics' 2007-08 input-output tables. The model is calibrated based on the 2007-08 level of the terms of trade.
- **Rich industry detail**. The model distinguishes 111 industries.
- **Sophisticated production processes.** Output in the model is produced by labour, land, fixed factors and nine additional types of capital: transport equipment; machinery; information technology; structures; dwellings; transfer costs; mineral exploration; research; and other intellectual property.
- **Company tax system.** The model reflects many features of the company tax system, including: deductibility of debt; revenue clawback through dividend imputation; depreciation allowances that reflect an historical cost basis and other aspects of tax laws; expensing of certain investments; and foreign tax credit arrangements.
- **Fixed factors.** The model identifies fixed factors in industries in which Australian Bureau of Statistics data suggest there may be above normal rates of return on capital and where there are economic grounds for believing these may be sustainable: mining, banking and finance, telecommunications, and beverage manufacturing. These are further divided into location-specific, immobile factors (90 per cent) and firm-specific, mobile factors (10 per cent).[23]
- **Foreign marginal investor.** The model assumes that the marginal investment is funded by a foreigner, that capital is perfectly mobile between countries, and that investments at the margin are funded through a mix of debt and equity that matches the historical average.
- **Profit shifting.** Company tax can affect where firms declare their profits for tax purposes. The model assumes a semi-elasticity of the tax base to the statutory tax rate of -0.5. This affects both the revenue take and the firm's cost of capital.[24]
- **Labour force participation.** Households choose between employment and leisure, taking account of the after-tax wage available.[25]

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22 This timeline is consistent with the transition path in response to tax changes within the Monash Multi-Regional Forecasting Model, a widely used dynamic model of the Australian economy.

23 Actual rates of return have been estimated for each industry using data on capital stocks and net operating surplus from the Australian Bureau of Statistics. An industry is said to be earning economic rents, attributed to fixed factors, when their estimated actual rate of return is higher than a 'normal' rate for that industry. In modelling the European business tax system, De Mooij and Devereux (2010) assume that 30 per cent of fixed factors are firm-specific. The model assumes a lower share, reflecting the greater role of natural resource wealth in the Australian economy and its lower level of international economic integration.

24 Recent modelling of European business tax (de Mooij and Devereux 2010) assumed a semi-elasticity of -0.73. The model assumes a lower elasticity reflecting the smaller role of multinationals in the Australian economy.

The model also relies on a range of general assumptions, many of which are shared with other long-run computable general equilibrium models. Consumers choose between different purchases to maximise their wellbeing. Firms choose how to produce and how much to produce in order to maximise profits. Wages adjust so that labour markets clear. The capital stock adjusts so that the after-tax rate of return matches the required world rate. Australia is a price taker in import markets and is close to a price taker in most export markets.[26]

The main welfare measure is full household consumption. This takes account of household consumption and leisure.

Modelling exercises are always a simplification of the real world. They are designed to capture the most important features of the economic response to policy changes in a sufficiently flexible way. Not all features of the decisions affected by tax changes are incorporated. In particular, while the modelling takes account of the historical shares of corporations and unincorporated entities in the economy, and the historical shares of debt and equity financing, it does not model potential changes in the legal structure of business operations or leverage in response to policy changes.

References

Dandie, S. and Mercante, J. 2007, Australian labour supply elasticities: comparison and critical review, Treasury working paper, 2007-04.

De Mooij, R. and Devereux, M. 2011, An applied analysis of ACE and CBIT reforms in the EU, *International Tax and Public Finance*, vol 18, pp 93–120.

25 The assumed uncompensated elasticity of labour supply of 0.2 is consistent with the range of empirical estimates from Australian studies (Dandie and Mercante 2007).

26 An elasticity of demand of -12 for Australian exports is assumed for most industries, but a lower elasticity of -6 applies in industries where Australia has some market power (some parts of agriculture and mineral commodities) or product differentiation (such as tourism and education).

Appendix C — About the Business Tax Working Group

Membership

Chris Jordan AO — Chair

Chris Jordan is a Fellow of the Institute of Chartered Accountants, the Taxation Institute in Australia, and the Australian Institute of Company Directors and is a Solicitor of the Supreme Court of New South Wales.

He is the Chairman of the Board of Taxation, which is an advisory body to the Federal Treasurer, and the Chair of the Committee for Sydney. He is also a board member of the Sydney Children's Hospital Foundation and the Bell Shakespeare Company. Chris was awarded the honour of Officer of the Order of Australia in the 2005 Queen's Birthday Honours list for high-level advice to Government.

Peter Burn

Dr Peter Burn, Director of Public Policy, Australian Industry Group (Ai Group), has extensive experience in taxation policy through his role at Ai Group since 2002 and as Director — Policy at the Business Council of Australia with particular responsibilities for taxation policy from 1997. Peter was also the Secretary of the Business Coalition for Tax Reform in the years around the Australia's New Tax System.

Frank Drenth

Frank Drenth has been in the role of Executive Director of the Corporate Tax Association (CTA), since 1998. The CTA represents the taxation interests of about 120 of Australia's largest companies. He is also Deputy Chair of the Business Coalition for Tax Reform, which brings together the views of the broader business community on tax reform issues.

Teresa Dyson

Teresa Dyson is a Tax Partner in Ashurst's Brisbane office, specialising in providing income tax advice on corporate and financing issues to domestic and international businesses. Teresa is a member of the Board of Taxation. She is also the National Chair of the Law Council of Australia, Business Law Section (Tax Committee) and, in that capacity, represented the Law Council of Australia at the Tax Forum. She is currently recognised as a leading individual in tax in Chambers Global 2012 and Best Lawyers 2012.

John Freebairn

John Freebairn holds the Ritchie chair in economics at the University of Melbourne. He has degrees from the University of New England and the University of California, Davis. Prior to joining Melbourne in 1996, his preceding career includes university appointments at the ANU, LaTrobe and Monash, and periods with the NSW Department of Agriculture and at the Business Council of Australia. John is an applied microeconomist and economic policy analyst with current interests in taxation reform and environmental economics.

Tim Lyons

Tim Lyons was elected as Assistant Secretary of the Australian Council of Trade Unions (ACTU) in August 2008. Prior to that, he was an official of the National Union of Workers (NUW) for over 13 years, and represented members in a wide range of industries, including logistics, food, plastics, oil and gas and general manufacturing.

Tim is also a member of a range of government committees, including in relation to superannuation, workplace relations and procurement. Tim is a Trustee Director of HESTA superannuation fund, a director of The Union Education Foundation and the Australian representative on the Global Unions Committee on Workers' Capital.

Rob McLeod

Rob McLeod was appointed Ernst & Young's Oceania Managing Partner and CEO in 2010 and was previously Ernst & Young's New Zealand Country Managing Partner. He has more than 30 years experience in corporate and international tax.

Rob has held a number of high profile roles in New Zealand including Chairman of the New Zealand Business Roundtable. In 2001, he conducted a comprehensive New Zealand government tax review — the McLeod Review. In 2009, he was appointed to the government-sponsored Tax Working Group and the Capital Markets Development Taskforce, both of which had a strong focus on tax reform. He was also a member of the New Zealand Government appointed Consultative Committee on Capital Gains Tax in 1989. He has been appointed to numerous government committees, the latest ones focusing on defence, infrastructure and Maori economic development.

Jennifer Westacott

Jennifer Westacott took up the role of Chief Executive at the Business Council of Australia in April 2011.

Jennifer has extensive policy experience in both the public and private sectors. She has held critical leadership positions as the Director of Housing and the Secretary of Education in Victoria, and most recently was the Director-General of the New South Wales Department of Infrastructure, Planning and Natural Resources. Jennifer was a Director and National Lead Partner at KPMG and provided advice and assistance to some of Australia's major corporations on climate change and sustainability matters, and provided advice to governments around Australia on major reform priorities. She previously chaired the Public Sector Performance Commission in South Australia, and was a member of the Commonwealth Grants Commission.

Rob Heferen

Rob Heferen is the Executive Director of Treasury's Revenue Group, which is responsible for providing advice and assisting in the formulation and implementation of government taxation and retirement income policies and legislation as well as providing information on material changes to taxation revenue forecasts and projections.

Terms of Reference

Objectives

1. The Working Group will make recommendations on how the Australian business tax system can be improved to make the most of the challenges and opportunities arising from transformations in the broader economic environment, including the patchwork economy.

2. The revenue neutral reforms to the business tax system will aim to increase productivity, while delivering tax relief to struggling businesses.

Scope

3. The Working Group will focus on reform options that relieve the taxation of new investment:

   3.1. in the near term, by reforming the tax treatment of business losses; and

   3.2. in the longer term, by reducing the corporate tax rate further or moving to a business expenditure tax system, particularly an allowance for corporate equity.

4. For its final reports, the Working Group will provide specific analysis of these business tax reform options, including:

   4.1. description of how these reforms options operate overseas and evidence on their effectiveness;

   4.2. potential priorities for reform, including transitional paths;

   4.3. worked examples of how these options would affect business taxpayers, including their financial and tax accounts;

   4.4. revenue integrity provisions, such as measures necessary to limit: the inappropriate claiming of tax losses; the equity allowance to new equity; and small and closely held businesses converting labour into business income;

   4.5. how the reform options integrate with the rest of the tax system now and in the future;

   4.6. impacts on national income and macroeconomic risks; and

   4.7. costings.

5. The working group will also identify a range of off-setting budget savings from existing Commonwealth business taxation (or spending) measures. Changes to the GST should not be considered.

   5.1. The savings to be generated by the particular options will be costed by the Treasury in accordance with the budget rules.

6. In developing its recommendations, the Working Group should have regard to the report of the *Australia's Future Tax System Review* and relevant international experience and expertise.

Timing

7. The Working Group is required to provide the Treasurer with:

   7.1. an initial report on the proposed directions for improving the tax treatment of losses and offsetting savings in mid-November 2011;

   7.2. a final report on the treatment of losses and the offsetting savings in March 2012; and

   7.3. a further report on longer-term business tax reform options and offsetting savings by the end of 2012.

Consultation

8. For its final reports, the Working Group should consult widely with industry and the broader community.

9. The Working Group may establish technical sub-groups to consider specific issues or seek input from other sources of expert advice.

Support

10. The Working Group will be supported by a Secretariat within Treasury.

Chronology

October 2011 — Business Tax Working Group established

- The Working Group was established by the Treasurer to look at how Australia's tax system could be improved to make the most of the challenges and opportunities arising from the broader economic environment, including the patchwork economy. The Working Group's task is to be conducted in two phases:
  - Phase 1: consideration of reforms for the short-term, by improving the tax treatment of business losses.
  - Phase 2: consideration of longer-term reform directions for Australia's business tax system.

December 2011 — Interim report on the tax treatment of losses — released

- The interim report explored the tax treatment of losses in Australia, in particular how this treatment affects Australian businesses' ability to respond to emerging challenges and take advantage of new opportunities presented by changes in the local and international economy. The report also outlined possible reform options that may increase business productivity, while delivering tax relief to struggling businesses.

February 2012 — Interim report on the tax treatment of losses — consultation

- Submissions in response to the interim report closed in February.

March 2012 — Interim report on the tax treatment of losses — consultation

- Consultation meetings were held between Working Group members and interested stakeholders throughout March.

April 2012 — Final report on the tax treatment of losses — released

- The Working Group considers that loss carry back would be a worthwhile reform in the near term. However, the Working Group advised the Treasurer that it had not had an opportunity to explore the relative net-benefit of loss carry back compared with other business tax reforms.

- The Working Group also recommended that the Government undertake further work to develop a model for reforming the same business test. The Working Group considers that further analysis and consultation is required before any conclusions can be drawn on possible savings options to fund reforms to the tax treatment of losses.

May 2012 — Budget announcement of loss carry-back reforms

- On 6 May 2012, the Government announced that it would introduce a limited loss carry-back to the income tax law for corporate tax entities.

June 2012 — Focus on longer term reform of the business tax system

- In June 2012, the Government asked the Working Group to prioritise consideration of a cut to the company tax rate accompanied by measures which fully offset the cost by broadening the business tax base.

- Also in June 2012, the Working Group released a consultation guide setting out how the Working Group planned to involve the community in its consideration of business tax reform.

August 2012 — Discussion paper on longer term reform of the business tax system — released

- The Working Group released a discussion paper in August 2012 that sought views from stakeholders about whether a lower company tax rate funded by some specific base broadening options could deliver net benefits to the Australian economy.

September 2012 — Discussion paper on longer term reform of the business tax system — consultation

- Consultation meetings were held between Working Group members and interested stakeholders throughout September.

- Submissions in response to the interim report closed in September.

APPENDIX D — SUMMARY OF CONSULTATION ON DISCUSSION PAPER

On 13 August 2012, the Business Tax Working Group released a Discussion Paper that sought views from stakeholders about some specific base broadening options to offset the cost to revenue of a cut to the company income tax rate. The purpose of the Discussion Paper was to stimulate discussion, debate and feedback to the Working Group. It was not a position paper and the options canvassed were not recommendations.

Consultation meetings

Following the release of the Discussion Paper, members of the Working Group met with representatives of more than 20 stakeholders — including a mix of individual companies, industry groups and professional bodies. Consultation meetings were held in Brisbane, Sydney, Melbourne and Perth.

Written submissions

The Working Group received 83 written submissions in response to the Discussion Paper, including 62 public submissions and 21 confidential submissions. Public submissions were received from the following organisations and individuals:

Accommodation Association of Australia
Australian Academy of Science
Australian Bankers Association
Australian Chamber of Commerce and Industry
Association of Australian Medical Research Institutes
Australian Council of Trade Unions
Australian Industry Group
Australian Information Industry Association
Alandal Consulting
Association of Mining and Exploration Companies
American Chamber of Commerce in Australia
Australian Petroleum Production and Exploration Association
Arrium Limited
AusBiotech
Australian Shipowners Association
Australian Trucking Association
Australian Private Equity and Venture Capital Association
Business Council of Australia
BMT Tax Depreciation
BP Australia
BusinessSA
Chamber of Commerce and Industry WA
Chamber of Minerals and Energy WA
Chevron
CPA Australia
CSL Limited
Corporate Tax Association
Crossing, Edward
Group of Eight
Hogg, Craig
Housing Industry Association
Immersaview Pty Ltd
Infrastructure Partnerships Australia
Institute of Chartered Accountants Australia
Institute of Public Accountants
Invensys Operations Management
IT Industry Innovation Council
Janssen
Knowledge Commercialisation Australasia
KPMG
Lateral Economics
Law Council of Australia
Master Builders Australia
Medicines Australia
Menezes, Flavio
Michael Johnson Associates
Minerals Council of Australia
National Tourism Alliance
NSW Farmers
Pitcher Partners
Property Council of Australia
Research Australia
Roche Products Pty Ltd
Sedgman Limited
The Australasian Institute of Mining and Metallurgy
The Tax Institute
Truck Industry Council
United Voice
Uniting Church in Australia
Universities Australia
Washington Brown Depreciation Pty Ltd
WWF Australia

Public submissions are available on the Treasury website: http://www.treasury.gov.au/BTWG.

The Working Group encouraged stakeholders to provide evidence based responses to the discussion paper. The Working Group appreciates the effort that many stakeholders made in providing information and analysis for the Working Group's consideration.