

The Faulty Arguments Behind Australia's Corporate Tax

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The Faulty Arguments Behind Australia's Corporate Tax

Introduction

In Australia, the primary function of taxation is to finance government spending. Its secondary objectives relate to influencing social and economic outcomes, resource allocation, consumption patterns, the level and direction of savings, and the relative welfare of different groups.¹ Non-distortionary taxation is not necessarily an objective of the Australian system.

Australia's corporate tax is said to be very successful, raising substantial revenue, and there has been little debate about it over the past few years. While public debate has concentrated on personal income tax, there has been little demand for corporate tax reform. Arguments by the Business Council of Australia (BCA), for example, that corporate taxes are too high have been viewed as special pleading by lobby groups. This paper investigates Australian corporate tax and highlights a number of issues that deserve greater public awareness.

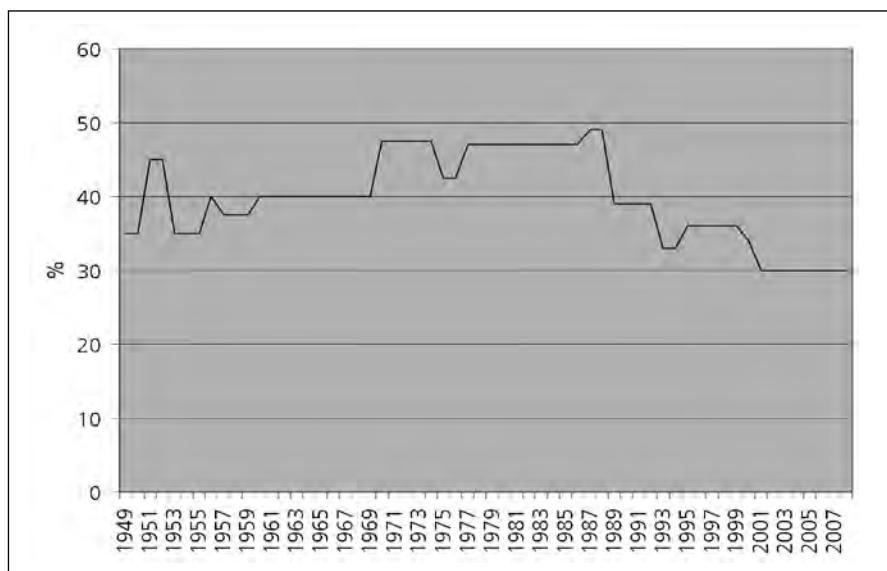
For example, the Australian corporate tax rate is high by world and OECD standards. The corporate tax take is high by OECD standards. Contrary to widespread opinion that large corporations pay very little (or even no) corporate tax, ATO data show that large corporations, which make up less than 0.5% of all firms, pay over 75% of corporate tax. The legal incidence of the corporate tax burden is uncertain. The rationale for levying a corporate tax relies on weak arguments, while the deadweight costs are likely to be very high. Consistent with the BCA's argument, the effective corporate tax rate in Australia has probably been rising over time. The international evidence suggests that high corporate tax rates retard economic growth.

Overall, this paper presents arguments that suggest the case for corporate taxes is uneasy. Corporate tax itself is a good revenue-raiser, but its true costs are uncertain. Consequently, it makes sense to have a cautious approach to this form of taxation; corporate tax rates should certainly be lower, not higher. Corporate tax reform is long overdue.

Corporate taxation in Australia

At present, corporate income is taxed at a flat rate of 30%. There is no tax-free income threshold. Australia operates a partially integrated personal and corporate income tax system, where corporate tax constitutes a withholding tax on personal income. Individual taxpayers pay tax on dividend income at their marginal tax rate. Those taxpayers with a high marginal rate pay in the difference between their rate and the corporate tax rate. Taxpayers with a low marginal rate can offset other income against the withholding tax (called an imputation credit) or receive a refund for the difference.

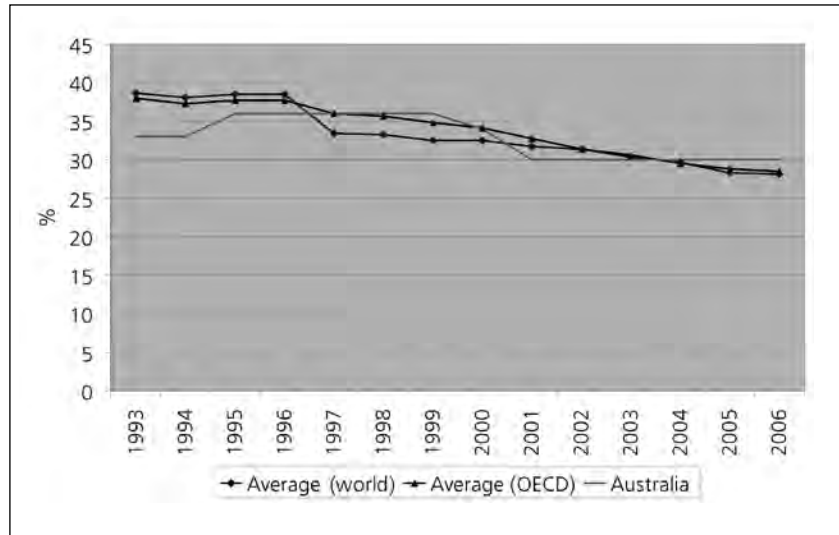
Figure 1: Australian corporate tax rates



Source: Data from Julie Smith⁴

KPMG have made international comparison data available starting from 1993. Using that data, I have calculated world average rates (across sixty-five economies) and OECD (unweighted) average corporate tax rates. Figure 2 shows the result of that exercise. Both the average world corporate tax rate and the average OECD corporate tax rate have declined over the period 1993–2006. The Australian corporate tax rate has also declined over the period, though it did increase in the mid-1990s. As of 2006, the Australian corporate tax rate was slightly higher than the (unweighted) average corporate tax rates for the world and the OECD.

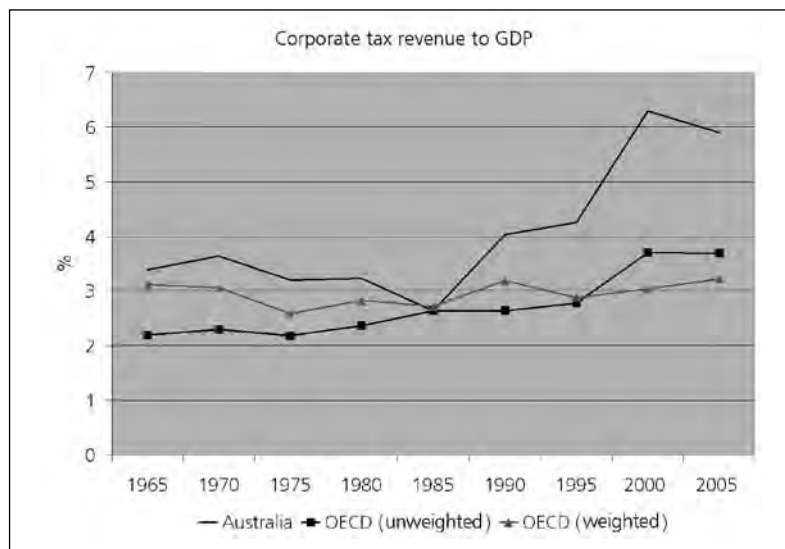
Figure 2: Comparative corporate tax rates (unweighted)



Source: Treasury and KPMG International⁵

But headline corporate tax rates are only one part of the issue. A far more important aspect of the tax burden is how much revenue the tax system raises. In 2008–09, the corporate tax is expected to raise \$73.49 billion, making up about 33.9% of income tax revenue. That overstates the amount of revenue the Treasury will get to keep, as corporate income tax is, in principle, prepayment of personal income tax. Neville Hathaway and Bob Officer of Capital Research have undertaken a very careful analysis of the creation and usage of imputation credits. Their argument is that about 35% of corporate tax revenue is redeemed at the personal level as a prepayment of personal tax. That would imply, everything else being equal, that Treasury can expect to net about \$47.8 billion from corporate income tax.

Figure 3: Comparative corporate tax revenue



Source: OECD revenue statistics

Figure 3 shows the ratio of corporate tax revenue to GDP for Australia and also GDP-weighted and unweighted corporate tax revenue to GDP ratios for the OECD. Not only is Australian corporate tax *revenue* high by OECD standards, it has also increased very dramatically since 1985, even though the corporate tax *rate* has declined since in the same period. So, in an environment where the corporate tax rate has declined, the corporate tax take has increased. This has been observed in many economies, not just Australia, and is partly a result of cuts in headline tax rates being accompanied by base-broadening. The GDP-weighted average corporate tax take is slightly higher than it was in 1965, while the unweighted average corporate tax take is much higher than it was in 1965. In short, there is no evidence that international tax competition is reducing corporate tax revenues, as is sometimes argued.⁶

In an environment where the corporate tax rate has declined, the corporate tax take has increased.

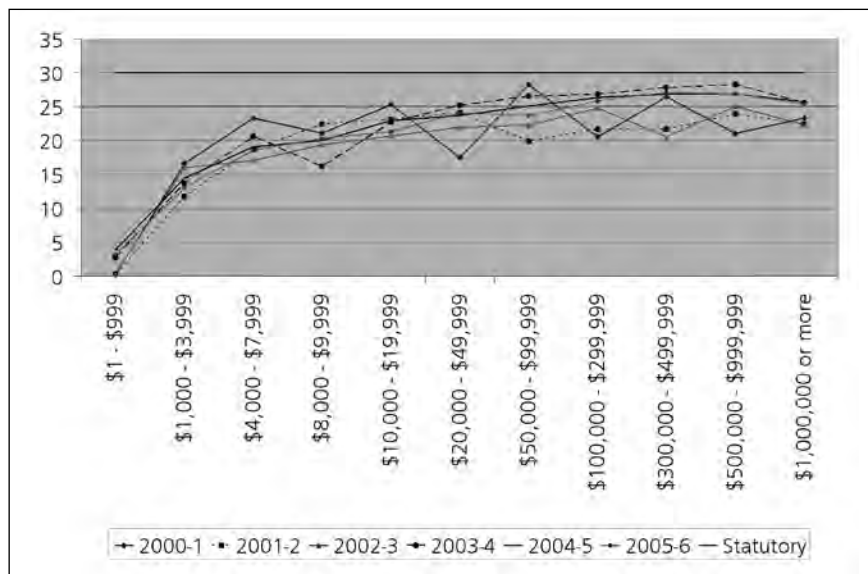
Who pays corporate tax?

The mechanics of corporate tax

The mechanics of corporate tax are simple: all companies face a flat rate of 30% of assessable income. Unlike the US, Australia does not levy a progressive corporate income tax, and unlike the pre-1974–75 situation, public and private companies pay the same nominal rate. If firms' effective tax rate were plotted against their taxable income, we would observe a flat line at the corporate tax rate (30%).⁷ When I actually undertake that exercise (shown in figure 4), though, something very different emerges.

The corporate effective tax rate follows the same pattern a progressive tax system would.⁸ Those firms with very low taxable incomes appear to pay lower effective rates than firms with higher taxable incomes. The difference between the effective tax rate and the statutory tax rate is explained by the existence of tax offsets, foreign tax credits, the franking deficit tax offset, and 'other refundable credits.'⁹ Smaller firms face a consistently lower effective tax rate than do larger firms. This could be explained by smaller firms having a precarious existence and highly variable profitability. Unfortunately, the data are too aggregated to explore that idea any further. In addition, the difference between the effective tax rate and the statutory tax rate is highly variable—although in the last two years it was much less volatile. The important issue here is that the corporate tax does not function as a flat tax would.

Figure 4: Effective and statutory corporate tax rates by taxable income



Source: Author's calculations and ATO Tax Statistics (Various)

It is not just the effective tax rates that are distorted: a very small number of the firms subject to corporate income tax are responsible for paying the majority of the corporate tax revenue (see table 1). Those firms that have more than \$1 million in taxable income make up less than half of

1% of the total number of firms, yet in 2005–06 they paid 75.6% of net corporate income tax. To provide a starker statistic, ninety-two respondents to a Business Council of Australia survey paid \$18.1 billion in corporate income tax—nearly 37% of the total corporate tax revenue paid in 2005–06.¹⁰ Similarly, Tax Commissioner Michael D’Ascenzo recently indicated that ‘large corporates with a turnover of \$250 million or more contributed 65% of company tax in 2006–07. And of this, the top 50 contributed 71%, and the top 100 companies contributed 82%.¹¹ The Australian corporate tax burden is highly concentrated on a relatively small number of firms.

It could well be argued that those firms earn the vast majority of profits in Australia, and consequently it is unsurprising that they should pay much more in corporate tax. I tested that argument by calculating their share of the total income and taxable income of all entities that pay Australian corporate tax, and comparing that with their net tax share. In 2005–06, these firms earned 55.37% of total income and 73.11% of taxable income while paying 75.6% of net corporate income tax. The corporate income tax is not as distorted as the personal income tax, where the top 1% of taxpayers earned 9.4% of taxable income and paid 16.5% of net personal income tax. John Braithwaite has written that ‘clearly both Australia’s and America’s wealthiest corporations do not pay their fair share of tax.’¹² The data show that this type of argument is simply not true.

Table 1: Distribution of firms and net corporate tax

	Proportion of firms (%)	Proportion of net corporate tax (%)	Effective tax rate (%)
1996–97	0.30	64.45	24.81
1997–98	0.32	67.45	23.60
1998–99	0.34	65.95	23.86
1999–2000	0.38	66.87	23.28
2000–01	0.33	70.99	23.32
2001–02	0.35	69.79	22.41
2002–03	0.37	70.54	22.27
2003–04	0.39	70.20	25.54
2004–05	0.38	72.59	25.68
2005–06	0.44	75.60	25.36

Source: ATO tax statistics and author’s calculations

Corporate tax incidence

In the analysis shown above, I have shown who directly pays the corporate net income tax—corporations. Many economists, though, would be dissatisfied with this type of analysis. Tax incidence studies investigate who bears the economic tax burden, as opposed to who actually pays the tax. These types of studies differentiate between the legal incidence of taxation (what I have shown above) and the economic incidence of the taxation. The legal incidence refers to the distribution of tax payments based on who has the legal obligation to remit the tax to the government. The economic incidence is based on the economic impact a tax has on behaviour. In part, it is the impact a tax has on economic welfare.

Economists routinely assume that legal incidence and economic incidence are different, and they are unsure as to who bears the burden of corporate taxation. There are three groups that could bear the economic incidence of corporate tax. First, consumers could pay the tax, in the form of higher prices. Second, workers could pay the tax, in the form of lower wages. Finally, investors could pay the tax, in the form of lower returns. There is a large literature that attempts to untangle

the incidence of corporate tax.¹³ Economists agree that investors bear the short-run tax burden, but are they are less certain on who bears the long-run burden. A 2006 paper by the US Congressional Budget Office suggests that in the US over 70% of the corporate tax burden is borne by workers in the form of lower wages, and only 30% by investors.¹⁴ The study found the effect on consumers was very small. The argument is that in an open and competitive economy, it is unlikely that the tax burden could pass forward to consumers. This is most likely the case for the tradable sector, but consumers will bear a small component of the corporate tax in the non-tradable sector.¹⁵ That implies the corporate tax burden is largely shared by investors and workers.

Why have corporate tax at all?

From the perspective of those in government who want to create fiscal illusion—where the tax burden is made to look smaller than it really is—the corporate tax is ideal.¹⁶ Voters and taxpayers are uncertain where the incidence of the tax falls, and even how much net revenue the tax raises. There are clear reasons in political economy to impose a corporate tax, even if it seems somewhat cynical to focus on them. But what of the purely economic aspects of the corporate tax?

General principles

Three reasons can be given for imposing corporate tax: its *desirability*, its *necessity*, and its *convenience*.¹⁷ While all three reasons are plausible, they are not necessarily convincing. The *desirability* of corporate tax arises primarily from the ability to tax foreigners. It is entirely plausible to argue this is desirable, but the motive of taxing foreigners needs to be tempered by awareness of the cost this form of taxation imposes on the domestic economy, and also by the desire to attract foreign investment. The issue of desirability also raises the possibility of Pigovian taxes, which are used to overcome so-called market failure in the form of externalities. For example, if we believe that excessive car use contributes to greenhouse gas emissions, we could impose a tax on petrol that would reduce demand and so reduce greenhouse gases in the atmosphere. That example is quite clear-cut, and petrol is subject to very high taxes in most countries. In the case of corporate tax, there is the question of what externalities the corporate form imposes on society, and how the corporate tax resolves that market failure. Since no clear answer can be given to that question, corporate tax's function as a Pigovian tax should be downplayed.

The second argument in favour of the corporate tax is based on its *necessity*. This argument holds that the corporate tax serves as a 'backstop' to the personal tax system, and generally serves to avoid distortions in the overall tax system. The logic underlying this argument is that the solution to economic distortions due to a high personal tax rate is to have a high corporate tax rate. There are two interrelated arguments here. The first is that corporate tax is necessary to prevent individuals from organising their personal affairs through the corporate form to avoid personal income tax. It is not clear how big a problem this is. For example, Nicholas Gruen suggests that 'The ease with which a taxpayer can reduce their effective personal tax rate through incorporation is frequently overstated.'¹⁸ Gruen makes the argument that incorporation at best defers personal tax payments, but does not allow individuals to avoid personal taxation. In apparent contrast to Gruen, Braithwaite writes, 'the wealthy can *greatly* reduce their [tax] contribution by legally classifying themselves as a company instead of as an individual.'¹⁹ He immediately seems to contradict himself, however, when he goes on to argue that legal efforts to prevent this sort of activity introduced in the 1990s 'appear to have been successful.' In effect he argues the increase in corporate taxation in Australia 'simply highlights the "fiscal termites" elsewhere.'²⁰ Consistent with Gruen, this suggests that Australians are not actually able to convert large amounts of personal income into corporate income.

Australians are not actually able to convert large amounts of personal income into corporate income.

Braithwaite's and Gruen's arguments indicate that the personal tax system has few leakages. Consequently, the personal tax system may not need to have a backstop. Yet the old adage, 'a tax delayed is a tax not paid' still applies. Individuals who allow income to accumulate in corporate vehicles control the timing of their personal income tax liability, and likely will be able to reduce

their effective personal tax rate. In the interim, they pay the corporate tax rate. This tax avoidance strategy, while legal, will result in efficiency costs.

The second argument on the necessity of corporate income tax is closely related, yet less plausible. This argument recognises that taxation distorts the economy. Consequently, to minimise these distortions it is necessary to tax everything. Joel Slemrod refers to this as being a ‘folk theorem.’²¹ Further, he describes this as being ‘the most informal argument of all’ supporting corporate income tax.²² He concedes that a lot of formal economic theory on taxation (known as optimal tax theory) seems to suggest something like the folk theorem. But formal theory does not support corporate tax in small open economies. In his empirical analysis, Slemrod finds no evidence supporting the folk theorem, but does suggest his evidence is consistent with the backstop theory.

The *convenience* argument for corporate tax is largely self-explanatory. Corporate taxation is a source of easy revenue for government. The costs of corporate tax to government are low, it is politically popular, its incidence is uncertain, and corporations themselves do not vote (though many of their stakeholders do). The fiscal illusion and lack of democratic accountability associated with corporate taxation makes it very convenient to impose. Joseph Pechman goes further by arguing that ‘A special tax on the corporate form of doing business is considered appropriate because corporations enjoy special privileges and benefits.’²³ Yet this argument seems particularly weak, and Pechman does indicate that it was introduced to avoid a constitutional challenge to the corporate tax in the US. Pechman recognises the weakness of the argument and ultimately justifies the corporate tax on the basis of the backstop theory.

The arguments in favour of corporate tax need to be weighed against the costs of imposing it. The excess burden (or deadweight cost) of corporate tax is that it causes resources to be misallocated. There are three separate sources of inefficiency that can be identified.

First, corporate taxation leads to a misallocation of resources across the corporate and non-corporate sectors of the economy.²⁴ Jane Gravelle argues that this distortion has received most attention in the academic literature.²⁵ There is a large US literature that addresses the extent of

this type of deadweight loss from corporate tax. Unfortunately, the empirical estimates of corporate tax’s deadweight costs vary from 5% to over 100% of revenue raised.²⁶

Second, corporate income tax reduces economic efficiency, productivity, and growth over time. Ireland has demonstrated this point very well by dramatically lowering corporate income tax rates. The increase in investment flows and increased Irish economic growth are often directly attributed to the low corporate tax regime.²⁷ Ireland is not a special case. Young Lee and Roger Gordon investigated the

relationship between corporate taxation and economic growth using a cross-section of seventy economies, including Australia, from 1970 to 1997.²⁸ They found a consistently negative relationship between statutory corporate tax rates and economic growth—a 10% decrease in the corporate tax rate, everything else being equal, can be expected to increase subsequent economic growth by between 1% and 2%. Interestingly, they find personal tax rates have no relationship with economic growth.²⁹ Simeon Djankov and his co-authors in a 2008 draft paper have exploited a new World Bank corporate tax database to investigate the impact of effective corporate tax rates on aggregate investment, foreign direct investment, and entrepreneurial activity over eighty-five economies, including Australia.³⁰ They report that corporate taxation has a huge impact on the economy. Higher corporate taxes reduce aggregate investment, foreign direct investment, and entrepreneurial activity, and increase the size of the informal economy.³¹

Finally, corporate income tax distorts the debt–equity financing choices of corporations and the dividend decision. In principle, the dividend imputation system in Australia should reduce the debt–equity distortion (at the expense of having high dividend payout ratios) and reduce the double taxation of corporate income.³²

As indicated, estimates of the corporate tax excess burden vary dramatically. At a 2006 American Enterprise Institute conference, Kenneth Judd argued that many previous studies had relied on simplifying but unrealistic assumptions that distort estimates of the corporate tax excess burden.³³

Corporate income tax reduces economic efficiency, productivity, and growth over time.

[E]conomists have argued that the corporate income tax reduces economic efficiency by more than alternative tax instruments. These arguments typically assume perfectly competitive markets, ignore risk, and do not consider economic growth through innovation, even though these elements are key features of any modern economy. The true economic cost of the corporate income tax is much greater than conventionally believed when we consider how it interacts with investment and growth in a modern, technologically advanced economy.

Unfortunately, Judd is unable to provide an estimate of the excess burden, apart from arguing that it is higher than otherwise thought. This is somewhat problematic. The magnitude of the corporate tax burden is largely unknown.

The Treasury view

The (unofficial) Treasury view of Australian corporate tax is set out in a 2004 paper by James Kelly and Robert Graziani.³⁴ They argue the role of company income tax is to tax the income of Australian residents and to act as a withholding tax on Australian-sourced income for foreign investors. Kelly and Graziani write,³⁵

Company income tax helps to ensure that residents are appropriately taxed on their income. Without company income tax, a resident could accumulate income tax-free in a company. Tax would be deferred until the resident sells the shares in the company or receives a dividend.

As if there was something wrong with that! This is a combination of the folklore theorem and the argument that corporate tax is a backstop to the personal tax system. As I have argued, this is a weak justification for corporate income tax, yet Kelly and Graziani write as if these arguments were beyond question or doubt. Indeed, they present them as being self-evident.

Kelly and Graziani suggest that choosing a corporate tax rate is a balancing act between taxing Australian residents and taxing foreign investors. Further, they imply that the balance is currently tilted towards foreign investors by having a lower tax rate for corporations than for individuals. When discussing the possibility of lowering the Australian corporate tax rate, they argue that the primary cost for Australia would be 'the reduced revenue collections from foreigners due to the lower company tax rate.'³⁶ They raise three additional considerations. First, lowering the corporate tax rate would constitute a wealth transfer from Australians to foreign investors. Second, increased foreign direct investment could lead to diminished domestic competition. Third, it would have the effect of '*further compromising* the effectiveness of company income tax in its role of taxing residents.'³⁷

There are many difficulties with these arguments. In the first instance, Kelly and Graziani assume that any decrease in the corporate tax rate will reduce tax revenue. Yet they show how over a twenty-year period (1984–2004) OECD corporate tax rates have fallen while revenues have increased.³⁸ They suggest that increased revenue is due to a broader tax base and increased profitability. The arguments about wealth transfers and reduced competition are difficult to evaluate in isolation from a more generalised discussion about foreign investment, competition policy, and taxation. The final point is telling. They take the view that the corporate tax system is *already* compromised in taxing Australians. In other words, for the corporate tax system to meet the folk theorem and backstop requirements, the corporate tax rate would need to be as high as the personal tax rate—presumably the top marginal rate. Given their implicit revenue-neutrality assumption, they do not envisage lowering the top personal rate. Rather, for them it is the corporate rate that is too low.

A 10% decrease in the corporate tax rate ... can be expected to increase subsequent economic growth by between 1% and 2%.

Is the corporate tax burden increasing?

The BCA has noted Australia's very high corporate tax burden and attempted to explain the increase over time.³⁹ In particular, they investigate the notion that profit share for corporations has

increased dramatically since 1984.⁴⁰ While they do find that profit share has grown since 1984, this cannot explain the increase in the corporate tax burden, which doubled from 1984 to 2006.

In the 2007–08 budget papers, Treasury responded with an analysis headed, ‘Measuring the effective company tax rate.’⁴¹ Here, Treasury argues that commonly used techniques of estimating effective tax rates are biased. By removing those sources of bias and creating a new measure labelled ‘economic profit,’ Treasury estimates the effective tax rate and argues it has declined in line with reductions in the nominal corporate tax rate. Treasury concludes that ‘company tax has been growing in line with economic profit’; its view is that corporates are paying more tax because they are earning more profits and that is how the system is designed to operate.⁴²

Unfortunately, Treasury does not provide specific details of its analysis. Nor does it provide the data for further analysis and comparison. Their measure, ‘economic profit,’ and the subsequent effective corporate tax rate, cannot be replicated.

To provide greater insight into the growth of the Australian corporate tax burden, I decompose the ratio of corporate tax revenue to GDP as follows:⁴³

$$\frac{R}{Y} = \frac{R}{C} \times \frac{C}{P} \times \frac{P}{Y}$$

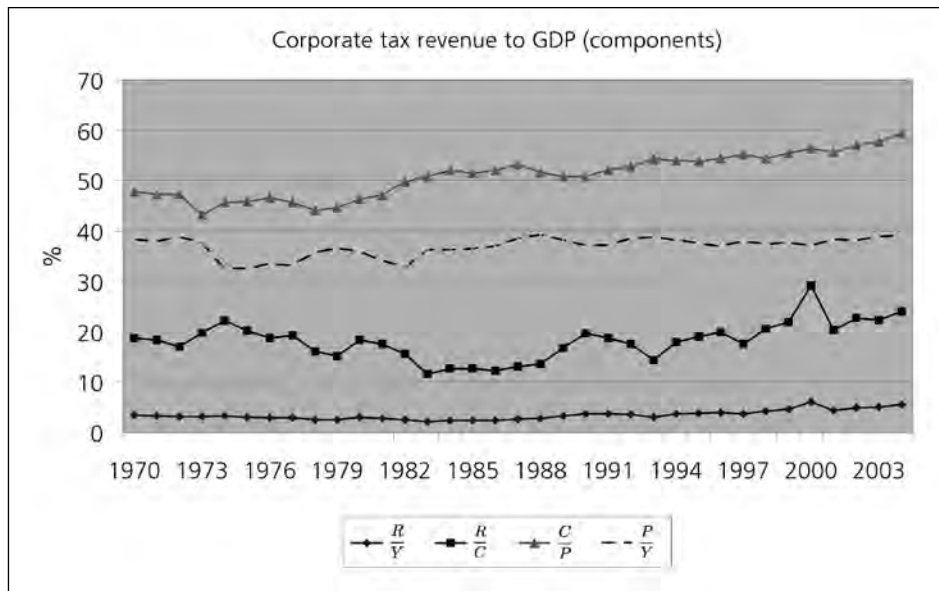
where R = corporate tax revenue, Y = GDP, C = total corporate profit (operating surplus), and P = total profit in economy.

Then $\frac{R}{C}$ = effective corporate tax rate, $\frac{C}{P}$ = share of corporate profitability,

and $\frac{P}{Y}$ = profit share of economy.

Created using data from the OECD national accounts, figure 5 shows the results of this decomposition. In principle, the measure of effective tax rates shown here is biased in the manner Treasury describes.

Figure 5: Corporate tax revenue to GDP decomposition



Source: Author’s calculations and OECD national accounts

The results are consistent with the BCA analysis. Profit share in the economy has increased since the early 1980s, but has been fairly stable over a long period of time. The corporate profitability share has increased, though, as has the effective corporate tax rate. In other words, the corporate tax base has become more comprehensive. As the economy has evolved, so the corporate form has become more attractive, but this has exposed more economic activity to the corporate tax, which

itself has become more comprehensive. So while the corporate tax rate itself may have fallen, the corporate tax base has expanded at a greater rate. All this leads to an increase in the overall corporate tax burden.

Given the paucity of Treasury data, it is not possible to compare this analysis with the Treasury analysis. For their analysis to be proven correct, Treasury would need to show that their measure, 'economic profit,' has grown faster than the corporate profitability share measure (their measure of the effective tax rate is falling, while the overall corporate tax take is rising).⁴⁴ That may well be the case, yet in their analysis of the Australian corporate income tax, Kelly and Graziani make no mention of increases in corporate profitability share driving increases in corporate tax revenue. Rather, they speak of broadening the tax base ('a significant policy influence') while reducing nominal tax rates as being the cause of increases in corporate tax revenue.⁴⁵ Their argument is consistent with the notion that the effective tax rate has increased.

To sum up: increases in corporate profit share are not enough to explain the massive increase in corporate tax revenue.

Corporate profitability itself has also increased over time—we keep reading of record profits—and some of the increase in corporate tax revenue can probably be explained by this increase. Treasury argues that all of the increase in corporate tax revenue is effectively explained by this increase. At the same time the effective corporate tax rates have also increased—though Treasury denies this—contributing to the increase in the corporate tax burden.

It is likely that the corporate tax is having a large negative impact on the economy ... The corporate rate of 30% should be lowered.

Conclusion

John Braithwaite has argued that 'Compared to individual workers, clearly ... Australia's ... wealthiest corporations do not pay their fair share of tax.'⁴⁶ The ATO data analysed in this paper do not support that view. It is quite clear that Australian corporate taxation is highly concentrated, with many corporates not paying any tax at all or paying very low rates of tax, while a small number pay a high level of tax. The corporate tax debate in Australia, to the extent it exists at all, has been overshadowed by the personal tax debate. This might not matter if corporate taxation were simply a prepayment of personal tax. Though it is claimed that this is how the corporate tax system works, it is clear that a lot of taxation of corporate income is *not* simply a prepayment of personal income tax. It is likely that the corporate tax is having a large negative impact on the economy.

This paper's analysis makes it clear that corporate taxation is in need of reform. The corporate rate of 30% should be lowered. The Australian corporate tax rate is high by international standards, as is the amount of revenue it raises. High corporate tax rates have been shown to have deleterious effects on the economy.

Government also needs to carefully consider the tax base and the distortions in effective corporate tax rates at lower levels of taxable income. It is quite possible that the potential benefits of having a flat corporate tax rate are not being realised. Of course, increasing the gap between personal and corporate tax rates may invite further aggressive tax planning. But that is not an argument for doing nothing. Rather the government should consider a 'whole of tax system' approach to tax reform, and reduce personal and corporate tax rates alike.

Endnotes

- 1 Australian Government Treasury, 'Treasury Submission to the Senate Economics References Committee Inquiry into the Structure and Distributive Effects of the Australian Tax System,' *Economic Roundup Spring 2003*, www.treasury.gov.au/documents/710/HTML/docshell.asp?URL=04.asp.
- 2 Julie P. Smith, *Taxing Popularity: The Story of Taxation in Australia* (Canberra: Australian National University, 1993), 152.
- 3 The figure shows data from 1949 for two reasons. First, before 1942, states also collected corporate tax, but I am unable to track down comprehensive data on the state corporate tax rates and I cannot be sure that my source (Julie P. Smith, *Taxing Popularity*) is comprehensive prior to 1949.
- 4 Julie P. Smith, *Taxing Popularity*.
- 5 Treasury, various budget papers; KPMG International, *KPMG's Corporate Tax Rate Survey: An International Analysis of Corporate Tax Rates from 1993 to 2006* (Amsterdam: KPMG International, 2006).
- 6 For a general discussion of tax competition, see Sinclair Davidson, *Tax Competition: Much To Do About Very Little*, CIS Policy Monograph 78 (Sydney: CIS, 2007).
- 7 Accounting income and taxable income are slightly different concepts. Certain items, such as depreciation, are treated differently for accounting and tax purposes. The ATO reports taxable income and I use those figures in the calculation, not the accounting figures.
- 8 The referees for this paper provided a number of alternative explanations for the discrepancy. One explanation revolved around the issue of taxable income and accounting income. I have used the taxable income figure provided by the ATO, which already takes account of depreciation and the like. Another explanation is that changes in the definition of taxable income are driving the result. It is true that the definition of taxable income can and does change over time, but should not impact the result here—I am reversing out a percentage from two numbers where 'by definition' one number should be 0.3 times the other number.
- 9 The ATO do provide data on these offsets and so on. In principle, it should be possible to add these figures back to the net tax figure and arrive at the theoretical tax paid ($0.3 \times$ taxable income), but that exercise does not yield the expected answer either. Either the data are too aggregated to be useful, or some other distortion remains in the tax system.
- 10 BCA (Business Council of Australia), CTA (Corporate Tax Association), and PriceWaterhouseCoopers, *Tax Nation: Business Taxes and the Federal–State Divide* (Melbourne: BCA, 2007). The calculation is based on 2005–06 corporate tax revenue reported in the relevant budget papers.
- 11 Michael D'Ascenzo, 'A New Dimension' (speech to the Corporate Tax Association Convention, Sydney, 12 May 2008), www.ato.gov.au/corporate/content.asp?doc=/content/00139238.htm.
- 12 John Braithwaite, *Markets in Vice, Markets in Virtue* (Sydney: The Federation Press, 2005), 30. It is interesting to note that Professor Braithwaite thanks the ATO for their ongoing support of his research. He specifically notes that the ATO did not fund this particular book.
- 13 See Jane G. Gravelle, 'Income Tax, Corporate, Federal,' in *The Encyclopaedia of Taxation and Tax Policy*, ed. Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle (Washington: The Urban Institute Press, 2005), 190–193.
- 14 William C. Randolph, *International Burdens of the Corporate Income Tax*, Congressional Budget Office Working Paper 2006-09 (Washington: Congressional Budget Office, 2006), www.cbo.gov/ftpdocs/75xx/doc7503/2006-09.pdf.
- 15 As above, table 2, 56.
- 16 For a general discussion of fiscal illusion, see Sinclair Davidson, *Fiscal Illusion: How Big Government Makes Tax Look Small*, CIS Policy Monograph 81 (Sydney: CIS, 2007).
- 17 See Richard M. Bird, *Why Tax Corporations?* International Centre for Tax Studies Working Paper 96-2 (Toronto: University of Toronto, 1996).
- 18 Nicholas Gruen, *Tax Cuts to Compete: The Influence of Corporate Taxation on Australia's Economic Growth*, CEDA (Committee for Economic Development of Australia) Information Paper 85 (Melbourne: CEDA, 2006), 18.
- 19 John Braithwaite, *Markets in Vice, Markets in Virtue*, 30, emphasis added.
- 20 As above, 29.
- 21 Joel Slemrod, 'Are Corporate Tax Rates, or Countries, Converging?' *Journal of Public Economics* 88 (2004), 1169–1186.
- 22 As above, 1170.

- 23 Joseph A. Pechman, *Federal Tax Policy Revised Edition* (Washington: The Brookings Institution, 1971), 105.
- 24 It is important to remember that the top marginal US corporate tax rate is high relative to the personal tax rate. This would lead to under-incorporation. See Austan Goolsbee, 'Taxes, Organizational Form, and the Deadweight Loss of the Corporate Income Tax,' *Journal of Public Economics* 69 (1998), 143–152, for a discussion of the US situation. In Australia the situation is different: the (flat) corporate tax rate is low compared to personal tax rates. This might encourage over-incorporation.
- 25 Jane G. Gravelle, *The Economic Effects of Taxing Capital Income*, (Cambridge, MA: The MIT Press, 1994), 77.
- 26 See Austan Goolsbee, 'Taxes, Organizational Form, and the Deadweight Loss of the Corporate Income Tax,' and Jane G. Gravelle and Laurence J. Kotlikoff, 'The Incidence and Efficiency Costs of Corporate Taxation When Corporate and Noncorporate Firms Produce the Same Good,' *Journal of Political Economy* 97 (1989), 749–780.
- 27 See Geoffrey Kingston, 'Our Treasurer Should Cultivate an Irish Lilt,' *Policy* 22:4 (Summer 2006–07), 3–7.
- 28 Young Lee and Roger Gordon, 'Tax Structure and Economic Growth,' *Journal of Public Economics* 89 (2005), 1027–1043.
- 29 This result is not consistent with previous empirical research. On this issue, see Alex Robson, *The Costs of Taxation*, CIS Policy Monograph 64 (Sydney: CIS, 2005), 10–12.
- 30 Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho, and Andrei Shleifer, 'The Effect of Corporate Taxes on Investment and Entrepreneurship,' draft paper (January 2008), www.economics.harvard.edu/faculty/shleifer/files/tax.Jan10.ThirdDraft.pdf. The World Bank database is a joint project of the World Bank and PricewaterhouseCoopers. PricewaterhouseCoopers and the World Bank, *Paying Taxes 2008: The Global Picture* (2007), http://www.pwc.com/gx/eng/tax/paying_taxes_2008.pdf forms part of the World Bank's 'Doing Business' project, of which details are available from the project website, www.doingbusiness.org.
- 31 Djankov his co-authors generally find that a 10% increase in the effective corporate tax rate leads to an approximate 2% decrease in investment, foreign direct investment and business density, with a 2% increase in the informal economy. This figure is consistent with the corporate tax elasticity of -0.2 reported by Jonathan Gruber and Joshua Rauh, 'How elastic is the corporate income tax base?', in *Taxing Corporate Income in the 21st Century*, eds. Alan Auerbach, James Hines Jr. and Joel Slemrod, (Cambridge: Cambridge University Press, 2007), 140 – 163.
- 32 A further potential distortion of the dividend imputation system is share buyback wave that Australia is experiencing. The structure of the transaction allows previously unused dividend imputation credits to be streamed to those shareholders who participate in the buyback. For further discussion of the imputation system, see Sinclair Davidson, *The Facts of Australian Corporate Taxation* (Sydney: Association of Certified Chartered Accountants, 2007) www.accaglobal.com/documents/taxreport.pdf.
- 33 Kenneth L. Judd, 'Corporate Income Taxation in a Modern Economy' (paper presented to the American Enterprise Institute conference 'Corporate Income Taxation and the Economy,' 10 May 2006).
- 34 James Kelly and Robert Graziani, 'International Trends in Company Tax Rates—Implications for Australia's Company Income Tax,' *Economic Roundup* (Spring 2004), www.treasury.gov.au/documents/930/HTML/docshell.asp?URL=02_International.asp, 23–47. Strictly speaking, the paper is the views of the authors 'and not necessarily those of the Australian Treasury.'
- 35 As above, 33.
- 36 As above, 36.
- 37 As above, 38, emphasis added.
- 38 As above, 27.
- 39 Business Council of Australia, *Corporate Taxation: An International Comparison* (Melbourne: BCA, 2005), www.bca.com.au/Content/101271.aspx, 13.
- 40 Profit share is defined as profits as a share of total factor income.
- 41 Australian Government Treasury, *2007–08 Budget Paper No. 1*, www.budget.gov.au/2007-08/bp1/download/bp1.pdf, 5-13–5-15.
- 42 As above, 5-15.
- 43 This follows the analysis by Peter Birch Sorensen, 'Can Capital Income Taxes Survive? And Should They?' (keynote paper presented at Venice Summer Institute workshop 'The Future of Capital Income Taxation,' Venice International University, San Servolo, 17–18 July 2006).

- 44 It is quite possible that the corporate form has become more valuable because economic profit has increased over time. In the short run, it is also possible that economic profit has grown faster than the corporate profit share of the economy. In the long run, though, (excess) economic profit should be competed away as more firms enter the market and the corporate profit share increases.
- 45 James Kelly and Robert Graziani, 'International Trends in Company Tax Rates,' 27.
- 46 John Braithwaite, *Markets in Vice, Markets in Virtue*, 30.

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