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Submission to the Business Tax Working Group Discussion Paper

The Justice and International Mission Unit welcomes this opportunity to make a submission in response to the Business Tax Working Group Discussion Paper.

The principles the Synod has adopted with regard to taxation were set in a 1997 resolution of the meeting of the Synod (made up of 400 representatives of the church), which stated:

(a) To affirm the principle that the payment of taxes is a moral responsibility that goes with citizenship;

(b) While acknowledging that taxation reform is a complex issue, to recommend to the Federal Government that the following guidelines need to undergird any reform of the Australian Taxation System:

- *(i) that the taxation system be primarily progressive and just;*
- *(ii) that the taxation system encourage a responsible use of our resources and stewardship of the environment;*
- *(iii) that the taxation system be designed in such a way as to lessen the gap between the rich and the poor;*

(c) To urge the Federal Government to incorporate within the Tax Reform agenda a resolution of Commonwealth-State taxation issues in such a way as to minimise State Government dependency on gambling taxes; and

The Unit is deeply concerned that the intention of providing a cut in the corporate tax rate is being driven by business lobbying under claims of the need to remain internationally competitive. The Unit regards tax competition as generally harmful. It results in the tax burden within countries being shifted away from corporate taxation in particular and towards other forms of tax whose burden falls disproportionately on the poor and the middle classes. For example, in Australia while corporate tax rates are being reduced there are calls for increasing revenue from the GST, taking more tax from the pockets of low and middle income earners.[1] The Unit notes that in a period of 30 years the corporate tax rate has been slashed from 46% to 30%.[2] The Unit therefore does not support a further cut in the corporate tax rate at this time, although it welcomes the intention of government that any shift in the corporate tax rate should be revenue neutral.

[1] Tim Colebatch, "The pleasure, and pain, of paying taxes", *The Age,* 18 September 2012, http://www.theage.com.au/opinion/politics/the-pleasure-and-pain-of-paying-taxes-20120917-262dx.html

[2] Discussion paper, p. 4.

The Unit does not believe all investment or economic activity is always positive, with negative examples including real estate speculation or investment in toxic mortgage backed securities.[3] It would welcome an exploration of reducing corporate tax on those activities that are productive to the economy, such as the provision of goods and services, while increasing taxes on speculative activities, such as through the introduction of a financial transaction tax in the form suggested by Professor Spahn.[4]

The Unit would support further tightening of thin capitalization rules and exploration of reducing incentives of the use of debt to finance investments over direct equity. It agrees that the current rules favour multinational companies over their Australian market competitors (page 25, paragraph 99 of the discussion paper). The Unit would support the removal of the arm's length tests and reducing safe harbor gearing levels (Option A.1). It would also support reducing safe harbours for financial institutions (Option A.3). It would also support capping interest deductions for all business taxpayers (Option A.5) as a means to reduce the corporate tax system's bias in favour of debt over equity (as stated on page 25, paragraph 102 of the discussion paper).

The Unit understands the conventional neo-liberal economic argument that cutting corporate tax rates attracts more investment and makes Australian companies more competitive internationally, leading to economic growth, so that a lower tax rate is levied on a larger base of economic activity resulting in a possible increase in tax revenue. The Unit is not convinced the evidence backs this claim in the longer term, as other governments then adjust their corporate tax rates to play the same game.

Treasury Secretary, Dr Martin Parkinson, pointed out the dilemma of government having to provide the services its citizens want if while maintaining revenue collection, or even having to expand it, in his recent speech:[5]

> *"Yet as Australian incomes have continued to rise over past decades, so too has community demand for the government provision of what economists call 'superior goods', including aged care, health, disability, education and social welfare. These pressures will only be exacerbated in coming decades as the population ages.*
>
> *At the same time, the taxation base is weaker than we had imagined in the mid-2000s. With hindsight, it is apparent that part of revenue collections then reflected a temporary bubble in the economy. The takeout message is that the days of large surpluses being delivered by buoyant tax receipts are behind us. While economic activity rebounded quite quickly after the global financial crisis, tax receipts are expected to remain substantially lower - around $20 billion per annum lower at the Commonwealth level alone - than pre-crisis projections.*
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> *The outcome is that - again as I have noted elsewhere1 - we face, as a community, a widening gap between the demands we are placing on government and what we are prepared to pay to fund government.*

[3] Filip Spagnoli, "There's no There There: Low Tax Rates and Economic Growth", 26 March 2012, http://ssrn.com/abstract=2029585
[4] Paul Bernard Spahn, "International Financial Flows and Transactions Taxes: Survey and Options", http://www.wiwi.uni-frankfurt.de/profs/spahn/pdf/publ/7-041.pdf
[5] Dr Martin Parkinson, "Treasury's Progressing Women Initiative: fostering cultural change over the long term", 16 August 2012, http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2012/fostering-cultural-change.

> *And we will not be able to meet these demands for new spending by increasing the efficiency and effectiveness of existing government spending alone (although this is important in its own right). Nor can we rely solely on our existing tax bases, as these are expected to deliver less revenue as a proportion of GDP, given capital and labour will become more mobile and the costs of securing that revenue increases. In addition, greater use of the tax bases we currently rely most heavily on - personal and corporate income tax - can adversely impact on productivity, participation and investment if not designed well.*
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> *What will be required - of governments at all levels - to meet the community's demand for new spending, will be more revenue or significant savings in other areas. In short, the public will need to make thoughtful decisions about what it wants government to provide, and how it expects these things will be provided."*

The Unit notes that a reduction in the corporate tax to 25%, without any other off-setting of revenue loss, would reduce government revenue by an amount that could otherwise be used to fund a National Disability Insurance Scheme. A reduction to the corporate tax rate to 29% would reduce government revenue by an amount more than that required to fund the new dental support scheme.[6]

Tax competition is an area where orthodox economics collides head-on with democratic ideals. This kind of "competition" between countries creates external pressures that undermine the right of electorates to decide whether or not they want to live in a high-tax or a low-tax economy, or how to organise the relative weights of different forms of taxation within the economy. Tax policies should be decided by domestic electorates, not by foreign bankers or other interest groups, and external pressure from tax competition short-circuits healthy democratic processes.

When countries compete with each other, healthy competition for foreign investment involves competing to have better institutions, rule of law, good infrastructure, technology, education, and efficient markets. By contrast tax competition between countries is of the unhealthy kind: for this kind of competition involves countries engaging in beggar-thy-neighbour games to suck financial capital and investment out of each other by offering lower taxes (or more secrecy or laxer regulation) which do nothing to improve efficiency or enhance competition - indeed, like any other form of subsidy, these incentives are likely to promote inefficiency. The advantage gained by one country from lowering its taxes is often short term because it is quickly offset by similar moves in neighbouring countries. This leads to long term revenue losses in all the countries involved. Further, much of this tax competition is driven by secrecy jurisdictions[7], that offer both low tax rates and legal

[6] Table 2, page 24 of the discussion paper and Tanya Plibersek, "$4 Billion Dental Spend on Children, Low Income Adults and the Bush", Media Release, 29 August 2012, http://www.health.gov.au/internet/ministers/publishing.nsf/Content/mr-yr12-tp-tp074.htm?OpenDocument&yr=2012&mth=08

[7] While many 'secrecy jurisdictions' are also defined as 'tax havens', the definitions of the two are different. The Australian Taxation Office is now also using the language of 'secrecy jurisdictions', and has indicated a particular focus on Vanuatu, Liechtenstein, Switzerland, Panama, Samoa and the Channel Islands.

The Tax Justice Network definition of a secrecy jurisdiction is in three parts. Firstly, secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. It must deliberately create laws that wholly or mainly relates to activities that take place 'elsewhere'.

frameworks that assist corporations in tax avoidance and tax evasion from tax authorities in other jurisdictions, as noted by the reference to “off-shore profit shifting” by corporations in the discussion paper (page 1, paragraph 4; page 11, paragraph 44).[8] As noted in the discussion paper (page 11, paragraph 43), it is not possible to compete with the tax rates of many secrecy jurisdictions such as those listed as examples in Table 1.

Table 1. Tax rates in selected secrecy jurisdictions and Australian companies with subsidiaries in these jurisdictions.[9]

Secrecy Jurisdiction	Effective Corporate Tax Rate (%)	Secrecy score on the Financial Secrecy Index[10]	Number of ASX 100 companies with subsidiaries in the jurisdiction	Total number of subsidiaries of ASX 100 companies in the jurisdiction
Jersey	0	78	10	100
Cayman Islands	0	77	12	58
Mauritius	3	74	8	27
Ireland[11]	12.5	44	11	39
Hong Kong	16.5	73	34	123

As an example of this race to bottom on corporate taxes, in February President Obama announced a new plan to reduce the “book” or nominal US corporate income tax rate from 35 percent to 28 percent. Two weeks later, this was followed by the UK’s announcement that it would slash its top corporate rate to 22 percent by 2014, with the explicit objective of “maintaining the lowest corporate rate in the G-8.” Other EU countries are also reportedly thinking about responding in kind. On 1 April, Japan lowered its own nominal corporate tax rate to 36.8% from 39.5%. And in three years the rate will drop another 2.3 percentage points to 34.5%.[12]

Secondly, a secrecy jurisdiction deliberately designs the regulation they create for use by people who do not live in their territories so that it undermines the legislation or regulation of another jurisdiction.

Thirdly, the secrecy jurisdiction creates a deliberate, legally backed veil of secrecy that ensures those making use of its regulation cannot be identified to be doing so. While all three of these characteristics must be present for a state to be considered a secrecy jurisdiction, this third characteristic is the most important.

[8] See for example: Melaine Newman, ‘Vodafone: Undercover investigation exposes Swiss branches’, Bureau of Investigative Journalism, 6 March 2012; Jesse Drucker, ‘IRS Auditing How Google Shifted Profits’, Bloomberg, http://www.bloomberg.com, 13 October 2011; Dipesh Gadher, ‘Light-footed Google in $4.6bn tax dodge’, The Australian, 30 May 2011; and Lousia Peacock, ‘Taxman wants slice of Apple’, The Age, 10 April 2012.

[9] ActionAid, “Addicted to tax havens: The secret life of the FTSE 100”, www.actionaid.org.uk/taxhavens, October 2011, p. 5. The data of ASX 100 corporations with subsidiaries in these jurisdictions is taken from 2009-2010 annual reports of the companies.

[10] See http://www.financialsecrecyindex.com/index.html for the methodology by which the Tax Justice Network calculates the secrecy score.

[11] Ireland is usually not regarded as a secrecy jurisdiction itself, but its corporate laws make it attractive in tax dodging structures set up by many corporations.

[12] James S. Henry and Nicole Tichon, “Corporate Taxation – The Next Race to the Bottom”, Tax Justice Network, 30 March 2012, http://taxjustice.blogspot.com.au/2012/03/corporate-taxationb-next-race-to-bottom.html. This race to the bottom by governments on corporate tax rates is noted on page 17, paragraph 69 of the discussion paper.

Further, many companies pay no where near the nominal rate of tax in their country, making it even harder to compete in a race to the bottom on corporate tax rates. The Congressional Budget Office, an independent, non-partisan agency, has reported that the average US corporate tax rate on domestic profits - meaning the share of profits that companies actually pay in taxes — is at 12.1%. This is less than half of the statutory rate of 35%, which will be held up as the raison d'etre for American corporations' inability to compete and continually referred to as the highest rate in the world. In fact, the US corporate tax rate is at the lowest level since the early 1970s.[13]

Orthodox economic analysts try to counter all this by saying that while tax rates (particularly corporation taxes) have indeed been falling over the long term under tax competition, they argue that taxes (and particularly corporation taxes) as a share of GDP have been rising, at least in OECD countries, so the fears of tax competition are overblown.[14]

However, as noted in Chart 8 of the discussion paper the weighted average of company tax revenues as a proportion of GDP in OECD countries has been falling rapidly in recent years. Some of the bigger countries such as the US, Japan and Germany have seen corporation tax as a share of GDP fall since 1965. Tax competition is real, and it is biting.

Corporate profits as a share of GDP have been rising far more quickly than the rise even in this unweighted average mentioned above – meaning that corporate taxes as a share of corporate profits have in fact fallen sharply. Not only that, but it seems that there has been an expansion of the types of activities that are covered by corporate taxation - such as a trend for individuals to incorporate themselves as companies for tax purposes - which has boosted the headline figures for corporate taxation, while disguising the underlying dynamics.

By contrast, other forms of taxation such as sales taxes do not generally get forced lower by tax competition, and countries increasingly have to rely on these kinds of indirect tax. These kinds of taxes are regressive: they ultimately increase disparities in income and wealth.[15]

The Unit realizes many businesses argue that tax is a cost, therefore low taxes are generally desirable, and so tax competition, by pressuring countries to cut taxes, is therefore a good thing. However, prosperity in many countries has grown dramatically in line with rising tax takes. Taxes, if they are well spent, on good roads or education, for example, can enhance a country's ability to "compete" in global markets (a point acknowledged on page 11, paragraph 44 of the discussion paper).

In 2009, Australia's total expenditure on educational institutions was 6.0% of GDP. This was below the OECD average of 6.2%. This expenditure level is also partly the result of a one-off injection of funds from the government's stimulus spending package. The $16.2 billion 'Building the Education Revolution' programme was provided to upgrade physical infrastructure, including halls and

[13] James S. Henry and Nicole Tichon, "Corporate Taxation – The Next Race to the Bottom", Tax Justice Network, 30 March 2012, http://taxjustice.blogspot.com.au/2012/03/corporate-taxationb-next-race-to-bottom.html.

[14] http://www.taxjustice.net/cms/front_content.php?client=1&lang=1&parent=91&subid=91&idcat=102&idart=113

[15] http://www.taxjustice.net/cms/front_content.php?client=1&lang=1&parent=91&subid=91&idcat=102&idart=113

libraries, in Australian primary and secondary schools.[16] Australia needs further investment in education to keep up with other OECD countries and remain competitive in being able to provide an educated workforce.

The Australian Government's *Review of funding for schooling Final Report (The Gonski Report)* indicates that if the recommendations had been implemented in full during 2009, the additional cost to governments would have been about $5 billion or around 15% of all governments' recurrent funding for schooling that year. Based on its current proportion of total funding, the Federal Government would bear around 30% of the increase. How the additional cost is actually borne will need to be discussed and negotiated between all governments.[17] The point is though, that further long term erosion of the tax base will make it harder to maintain such spending and may reduce Australia's attractiveness as a place for certain types of investment if education standards fall relative to the rest of the OECD countries.

Second, while company managers often see taxes as costs, they are not costs in any sense of inhibiting the efficiency of markets. Instead, they are distributions to society. Tax incentives are subsidies, which provide companies with advantages over their competitors that have nothing at all to do with the quality or price of the goods or services that they are selling. In accountancy terms, competition happens above the line, not below it. These incentives artificially favour multinational companies over smaller firms, and this distortion does nothing to promote efficient markets.

The tax burden has shifted under the pressures of tax competition, powerfully worsening inequality within countries. The tax situation of the world's wealthy elites is improving as a result of tax competition. This problem has been particularly acute in poor countries, whose governments are far less able to adjust to the pressures of tax competition. The relative tax burden on corporations has fallen, while the tax burden on labour and spending has had to rise, which has demonstrably increased inequality. For example, the American journal Foreign Affairs published an article, co-authored by Matthew Slaughter, a former economic advisor to President George W. Bush.

> *Over the last several years, a striking new feature of the U.S. economy has emerged: real income growth has been extremely skewed, with relatively few high earners doing well while incomes for most workers have stagnated or, in many cases, fallen. . . . There is reason to worry even if one does not care about social equity. . . U.S. policy is becoming more protectionist because the American public is becoming more protectionist, and this shift in attitudes is a result of stagnant or falling incomes. Public support for engagement with the world economy is strongly linked to labor-market performance, and for most workers labor-market performance has been poor. . . . . The best way to avert the rise in protectionism is by instituting a New Deal for globalization -- one that links engagement with the world economy to a substantial redistribution of income. In the United States, that would mean adopting a fundamentally more progressive federal tax system.* [18]

Some regional and even global efforts have already been set up to counter the harmful effects of tax competition, though they are all weak or deeply flawed. A good example is the European Union,

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[16] K. Roberts, *Education at a Glance 2012: OECD Indicators,* Country Note - Australia, Sept 2012, p. 3, http://www.oecd.org/edu/eag2012

[17] Australian Government, *Review of funding for schooling Final Report*, Dec 2011, p. xviii, http://www.schoolfunding.gov.au

[18] http://www.taxjustice.net/cms/front_content.php?client=1&lang=1&parent=91&subid=91&idcat=102&idart=113

where efforts are underway – only weakly, so far – to co-ordinate tax policies. The OECD countries implicitly recognise the harm that tax competition can inflict on countries, with its initiative on harmful tax competition. "Some tax practices are anti-competitive and undermine fair competition and public confidence in tax systems," it says.[19]

The Unit notes the recognition of the problem of intangible assets and intellectual property (page 2, paragraph 12 of the discussion paper) being used or misused by corporations to engage in transfer mispricing. The Unit continues to urge the government to support substantial reform of the global approach to transfer pricing, noting the failures of the OECD arm's length principle to deal with this problem.[20] For example, one alternative would be the development of models of unitary taxation, formulatory apportionment or hybrid versions of the arm's length and unitary taxation system are possible as interim steps.[21]

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19 http://www.taxjustice.net/cms/front_content.php?client=1&lang=1&parent=91&subid=91&idcat=102&idart=113

20 Kerrie Sadiq, 'The Traditional Rationale of the Arm's Length Approach to Transfer Pricing – Should the Separate Accounting Model be maintained for modern Multinational Entities?', J. Australian Taxation **7(2)**, (2004), p. 198; and Michael Durst, 'It's Not Just Academic: The OECD Should Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010.

21 Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.