A Race to the Bottom?
Globalisation & Company Tax

ACTU Working Australia Tax Paper No. 2

Australian Unions
Working for a better life.

ACTU
australian council of trade unions

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September 2011

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Contents

The ACTU

The Australian Council of Trade Unions is the nation's peak body for organised labour, representing Australian workers and their families.

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The Working Australia Papers

The Working Australia Papers are an initiative of the ACTU to give working people a stronger voice about social and economic policy. Although low and middle income Australians ultimately bear the costs of poor policy decisions made in relation to tax, infrastructure, retirement incomes, welfare, and services, their voice is too often absent from national debates about these issues.

This paper has been researched and written by ACTU Research Officer Michael Fisher.

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The ACTU Tax Papers

Tax is always a hot political topic, but the Government's announcement that it will hold a Tax Forum has helped put the tax debate on the front pages. The tax debate in Australia tends to be one-sided. Well-funded business groups make a self-interested case for cuts to business tax, or regressive personal income tax changes, and are given extensive coverage by the media. Such proposals for "reform" are treated as self-evidently good things, with little evaluation of competing ideas. False or misleading claims about the tax system are sometimes presented as facts.

There is a need to push back against the misleading claims and self-interested demands of the typical participants in the tax debate. As the peak council for working Australians and their unions, the ACTU is in a strong position to provide such balance, by advocating for tax reform in the interests of low- and middle-income people and for Australian society more broadly. After all, around half of all federal tax revenue is raised directly from individuals, with workers also paying GST and other indirect taxes. The tax system affects and belongs to all of us, so it's important that working Australians have a voice on this important topic.

This series of discussion papers represents one part of the ACTU's participation in the tax debate. This is the second paper in the series. The first paper examined some myths and realities regarding the Australian tax system, as well as Australians' preferences for their taxes and society. Future papers will examine the ways that loopholes in the tax system enable some individuals and businesses to unfairly reduce their tax, as well as the need for further progressive personal income tax reform.

1. Principles for tax reform

The Australian tax system belongs to the whole community, not just to the business sector. Real tax reform is one of the key ways that we can improve Australian society. Tax revenue funds the provision of services and infrastructure that are so important to Australians, and the design of the tax system can also play a key role in shaping and build a fairer, more prosperous Australia.

Real tax reform is reform that is directed towards satisfying Australians' needs and preferences, and that positions Australia well for the future. Real reform ensures that the tax system treats people of similar means equally, without allowing some to exploit loopholes to avoid their obligations ('horizontal equity'). It means a progressive tax system, to ensure that all Australians pay their fair share ('vertical equity'). Real reform will also ensure that the tax system is as simple and efficient as it can be, without sacrificing other aims in the name of simplicity or efficiency.

'Reform' should not imply an unending series of cuts to business tax and tax rates for high-income Australians. It should strengthen, not weaken, governments' ability to provide the high-quality public services and social security that Australians want, need and deserve.

Reforms to the Australian tax system should:

1. Ensure that the tax system raises sufficient revenue to fund the provision of high quality services to the Australian community;
2. Make the system more equitable and progressive, with taxes rising with individuals' ability to pay;
3. Reduce the opportunities for individuals and businesses to avoid their obligations, particularly by disguising their incomes through contracting arrangements, trusts, and private companies;
4. Not reduce the proportion of tax revenue that is paid by business;
5. Ensure that superannuation delivers adequate retirement incomes to working Australians while making sure that tax incentives associated with super are focused on low- and middle-income earners;
6. Further reduce the effective marginal tax rates (EMTRs) that make it hard for low-income Australians to get ahead, and undermine workforce participation;
7. Reduce the distortions in the tax system that reduce the availability of affordable housing;
8. Promote jobs and investment in socially and environmentally useful projects; and
9. Ensure that Australians receive a fair share of the profits obtained by extracting our collectively-owned natural resources, including iron ore and petroleum

2. Executive Summary

Whenever the topic of tax reform is raised, a predictable chorus can be heard. Business groups claim that company tax is holding us back, and that cuts to the tax rate are necessary to spur investment and economic growth.

This paper critically examines these self-interested calls for tax cuts, and finds:

- There is no global race to the bottom on business tax;
- Our company tax arrangements are competitive, with our company income tax rate lower than many other developed nations' rates;
- There is no dearth of foreign investment in Australia
- When all business taxes are taken into account, Australia's business tax revenue as a proportion of GDP is low by international standards;
- Non-tax factors, like the availability of a highly skilled workforce, can be more important than tax for encouraging investment;
- Cutting the company income tax would further encourage tax avoidance by individuals; and
- A reduction in revenue from business taxes would shift the bill onto workers and consumers, undermining the fairness of the tax system.

Australians want a fair tax system that raises sufficient revenue to fund high-quality public services and a decent safety net. The tax system should do so in a way that is equitable, with business paying its fair share. If there are ways that the tax system can be changed in order to promote jobs and investment in socially and environmentally useful projects, without reducing companies' share of tax revenue, then they should be discussed at the tax forum. Simplistic calls for reductions in the company income tax rate should be dismissed.

3. Introduction

Most forms of tax are subject to political debate. Other papers in the Working Australia Tax Paper series examine the evidence and arguments relating to personal income tax, tax evasion and tax avoidance, as well as myths about the overall Australian tax system. This paper focuses on company tax and critically examines arguments that contemporary globalisation means rates should come down.

The design, rate and impact of company tax have always been particularly controversial issues. For many in business the tax is seen to be an increasingly damaging impediment to investment, growth and competitive success. To many others arguments for cutting or even abolishing company tax in the name of benefiting all are often code for further increasing the already hugely unequal distribution of wealth.

Underlying these different perspectives are sharply contrasting views of the relationship between company tax, investment and growth. For some the tax it is a key determinant. For others it is one of the many factors that businesses take into account when deciding when, where and to what extent they should invest.

In recent years the arguments about company tax have become enmeshed in the concept of globalisation. If the case for cutting the tax was arguable in the past, some assert, the advent of globalisation has settled the argument. Rates must fall. Global competitive pressures demand this be the case. The alternative is to fall behind in the endless race for global competitive success.

This discussion paper seeks to challenge such views. Of course taxes play a part in shaping investor behaviour. But the real-world relationship between tax and investment decisions is more complex and nuanced than that assumed by much public debate.

This complexity means that governments have more discretion than is commonly assumed to design and implement a company tax that is conducive to business making a fair contribution to the broader welfare of the Australian community while continuing to invest, innovate and grow. The relationship between globalisation and company tax was central to how the Henry Review Panel framed its discussion of company tax. While their discussion of the empirical evidence was more measured and careful[1], the Panel's headline statements left little doubt that globalisation demanded that the company tax rate in Australia come down:

'Globalisation carries profound implications for Australia's tax system and for the taxation of investment in particular. In a world of increased capital mobility, company income tax and other taxes on

1 The Panel's Final Report acknowledges that there is a continuing debate about the relationship between taxes and growth but does not explore the controversies and how they may condition the recommendations they make. Nor does the Panel engage with the evidence, some of which is cited in this paper, that non-tax factors routinely play a significant part in shaping investor behaviour. Instead the Panel chose to focus on evidence generated by neoclassical tax modelling, a mode of analysis that is typically insensitive to the variety of forms that capital takes in the real economy and which therefore tends to underestimate the complexity of how capital responds to changes in tax rates. By deciding to focus on such evidence the Panel effectively determined their conclusions in advance.

investment have a major impact on decisions by businesses on where to invest, how much and what to invest in and where to record their profits…Reducing taxes on investment would increase Australia's attractiveness as a place to invest, particularly for foreign direct investment. Reducing taxes on investment, particularly company income tax, would also encourage innovation and entrepreneurial activity.'[2]

This invites the conclusion that current tax rates are too high and that lowering them will necessarily deliver significant economic benefits. Much of the reasoning and evidence presented in this paper provides cause to doubt that business in Australia is over-taxed and that cutting rates is an essential pre-condition for new investment and continued growth. Rather, there is evidence that existing tax arrangements are competitive and consistent with innovation and attracting investment from overseas.

This discussion paper is organised into four parts. In response to arguments that company tax should be abolished, rather than simply cut, the first part of the paper discusses the reasons why companies should pay tax. The second part then critically examines the view that contemporary globalisation, involving the increased mobility of capital, means that governments have little choice but to cut company tax rates. This is followed by a discussion of empirical tax trends which shows that while average headline rates have been falling across the OECD there remains considerable variation between countries in relation to both statutory rates and effective rates. Finally, the paper argues for viewing company taxes in the context of the total tax costs that investors face in different countries, and presents some recent KPMG data which suggests that Australia already has one of the most competitive and innovation-friendly company tax regimes in the world.

The paper concludes by arguing that the future of Australia lies in investing in high quality education, skills and infrastructures. Present rates of company tax, both statutory and effective, play an important part in ensuring that companies make a fair contribution to paying for that investment. There is no evidence that they need to change.

[2] AFTS Review Panel (2010) Australia's Future Tax System Review Final Report, Detailed Analysis Volume One, p. 149.

4. The Case for Taxing Companies

Among businesses, neoliberal politicians and right-wing 'think tanks' taxing companies has never been particularly popular. But in recent years the case against the very idea of taxing companies appears to have been gaining a degree of additional ideological momentum. Within the world of online opinion there has been an increasing quantum of editorials, articles and 'new research' that advances the view that taxing companies is not only 'bad for business', it is also 'bad for workers'[3]. If, for politically expedient reasons, the tax cannot be abolished, then rates should at least be slashed.

Building on the anti-state intellectual climate generated by some varieties of 'public choice theory', the impression is sometimes cultivated that the only real advocates of company taxes today are government bureaucrats. They allegedly like company taxes because the 'real costs' of the tax are hidden by the difficulty of determining its incidence. This contributes to sustaining the 'fiscal illusion' that the costs of government are less than they actually are, so providing additional opportunity to expand the size and influence of the 'unproductive' public sector. If only voters and workers really knew how damaging company taxes were, the argument goes, popular support for them would wither – as would support for 'big government'.

Furthermore, the global economic crisis that began in 2008 is cited by some on the ideological right as helping to strengthen the case against company taxes. Overlooking the evidence that low taxes contributed to generating surplus capital and a consequent incentive to maximise speculative risk, the argument now is that job creating investment is being hindered, at least in part, by a hostile tax environment. The climate, so the argument goes, is not sufficiently pro-business and so it is time for policy makers to finally tackle the burdens and threats that company taxes allegedly present.

In sum, for some neoliberal economists, politicians and journalists, conditions always justify cutting or abolishing company taxes. Under boom conditions they threaten the continuance

of growth. Under recessionary conditions they threaten recovery. Any number of economic ailments, from unemployment to low productivity growth and weak skill formation, can usually be traced back to company tax.

Mainstream public debate in Australia does not yet routinely feature credible calls for abolishing company taxes. However, calls for radical cuts to rates have become common. In its submission to the Henry review of Australia's tax system the Business Council of Australia argued that the statutory rate should be slashed from 30 per cent to 15 per cent. The BCA were not alone in calling for radical

[3] In The Atlantic (28.10.10) senior editor Megan McArdle captures the zeitgeist prevalent among neoliberals today when she states: 'The FT has a piece today on the [US] administration's plans to lower the corporate income tax rate in exchange for simplification…This is a decent plan…but this seems like a good time to once again charge into the fray and argue that we ought to just eliminate the damn thing altogether.'

reductions. But the fact that such calls are rarely accompanied by an acknowledgement that company taxes nevertheless have a legitimate role to play as part of our tax policy architecture suggests that at least some of those who call for significant reductions see them as part of a longer term agenda of building the political momentum for eventual abolition.

Before discussing this or that rate of tax, it is therefore necessary to re-state the positive case for company taxes as such.

Firstly, companies benefit from public goods financed from taxation. The viability and profitability of many companies is made possible only by means of goods and services provided by various levels of government: transport systems; education; essential utilities; legal institutions; economic and social stability. The availability of a skilled, mobile and healthy workforce is a precondition for most business activity. Such a workforce does not simply exist - it has to be generated and sustained by substantial public investment in schools, universities, roads, trains, clinics and hospitals. This has to be paid for from taxation and companies, as beneficiaries from this public investment, should make a contribution to paying for it.

Secondly, company taxes act as an important 'backstop' to personal taxation. In their absence there will be an increased incentive and opportunity for wealthy individuals to re-classify their earnings as corporate income with the result that they will pay little or no tax. Abolishing company taxes would further weaken the already limited progressivity of many tax systems, giving further weight to the increasingly widespread suspicion that 'only the little people pay taxes'. If the proportion of tax revenue that is raised from companies falls, then to maintain the same overall level of revenue the share borne by workers and consumers would have to rise.

Thirdly, companies benefit from the legal privilege of limited liability. This enables companies to externalise and socialise many of the risks and losses they are responsible for, with the result that employees, communities and government are often left to absorb the economic, social and environmental damage that can result. As distinct legal persons companies should be taxed separately for the unique privileges they enjoy.

Fourthly, it is not true that cuts to marginal rates of taxes, such as company taxes, pay for themselves by stimulating higher rates of growth and therefore more tax revenues. This view has become an article of faith among supply-side ideologues and has been given spurious academic legitimacy by means of the 'Laffer curve'. Former senior economic advisor to President George W Bush, Professor Greg Mankiw of Harvard University, described those who held such views as 'cranks and charlatans' after his empirical research found that cuts to marginal rates of corporate tax actually led to reduced revenues[4].

Finally, it is not the case that company taxes are 'bad for workers' because much of the cost of such taxes is simply passed-on to employees in lower wages. The empirical support for such a view is highly

[4] http://gregmankiw.blogspot.com/2007/07/on-charlatons-and-cranks.html

sensitive to a number of deeply contentious modelling assumptions[5]. Moreover, this theory of company tax incidence leads to the highly implausible conclusion that corporations exploit tax havens and engage in aggressive tax planning for the purposes of paying their workers more. This will come as a surprise to those employees of corporations that report healthy post-tax profits but who nevertheless struggle to maintain the real value of their wages.

Nor is it clear, given the routine reluctance of senior corporate management to fully inform the mass of shareholders about the details of their tax strategies, that tax havens and planning are necessarily used to benefit investors. A more plausible view of corporate tax behaviour, that has little to do with paying workers more, is offered by Richard Murphy, of Tax Research UK, when he states: '…by and large the tax planning game is played by senior corporate management mainly for its own gratification by increasing the sum of retained profit over which they have control and to assist them in crystallizing their own share incentive based gains…Reductions in [the company] tax rate, in particular, should be seen as a mechanism for leveraging wealth to executive management of companies.'[6]

The distasteful reality of much real-world corporate tax behaviour sits at odds with the elegant supply-side reasoning that is increasingly and uncritically reproduced in parts of the media and by some politicians. In this view company tax should be cut or abolished because everybody suffers. A more plausible interpretation is that those who have benefitted most from the explosion in wealth inequalities around the world over the past 30 years wish to secure further cuts so that they can consolidate and further extend their gains.

[5] The US Congressional Budget Office, in its March 2011 report *Reducing the Deficit: Spending and Revenue Options* commented that the distribution of the corporate tax burden between owners of capital, consumers and workers is 'not clear' (p. 134). This ambivalent conclusion stands in stark contrast to the consensus among neoliberal economists that much of the burden falls on employees.

[6] http://www.taxresearch.org.uk/Blog/2008/06/03/the-tax-incidence-argument-is-wrong-corporate-tax-cuts-are-all-about-senior-management-greed/

5. Globalisation & Company Tax

All discussion about tax reform takes place in the context of a set of assumptions about the nature of contemporary economic change and the extent to which reform must conform to that change. It is common for advocates of particular reforms to bolster their case by framing their proposals as being consistent with prevailing economic trends. Favoured reforms are therefore argued to be 'inevitable' and 'common sense' responses to the 'new realities' of the global economy.

In the context of company tax reform a certain model of globalisation is usually invoked to suggest that cutting rates, or even their total abolition, is something national governments must at some stage inevitably do. Sooner or later, it is argued, conformity to the logics of contemporary globalisation must prevail. To do otherwise invites competitive decline due in large part to the refusal of foreign investors to pay more tax on their profits than those levied by governments elsewhere. However, this view ignores the real-world constraints investors confront when deciding where to locate, and overestimates the extent to which tax rates overshadow other commercial considerations.

The model of globalisation commonly assumed or asserted in such arguments is typically that of 'hyper-globalisation' (also known as the 'crude business school theory of globalisation'). The global economy is assumed to comprise investors possessed of perfect information who operate in fully integrated global markets in which capital is perfectly mobile and so faces disinvestment costs of zero. Such gratuitous assumptions are commonly made in open-economy neoclassical theory. They are made, in part, to facilitate quasi-scientific modelling of global economic dynamics. But they bear little relation to the complex empirics of real-world economic processes.

This would not matter if the hyper-globalisation model remained confined to the laptops of the mathematicians that now dominate the economics profession. But in recent years it has become increasingly common to see and hear elements of the model reproduced in mainstream policy discourse and media commentary on the invariably limited economic policy options open to national governments[7].

It is therefore important the model is subjected to critical scrutiny[8].

Arguably the core problem with models of globalisation that stress the mobility of capital, and so the imperative to cut company taxes, is the ascription of attitudes, behaviours and capacities to 'investors in theory' that are belied by observation of 'investors in reality'.

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[7] Watson, M. and C. Hay (2003) 'The discourse of globalisation and the logic of no alternative: rendering the contingent necessary in the political economy of New Labour', *Policy and Politics*, Vol.31 (No.3) pp. 289-305.

[8] It is beyond the scope of this brief discussion paper to examine all the relevant conceptual and empirical issues. Detailed critical discussion of hyper-globalisation theories is contained in Hirst, P. and G. Thompson (1996) *Globalisation in Question* (Polity Press: Cambridge) and Weiss, L. (1998) *The Myth of the Powerless State* (Cornell University Press: Ithaca, NY).

Capital investments in infrastructure, plant and machinery often involve substantial sunk costs the recoupment of which requires sustaining production in particular places for prolonged periods of time. In practice, root-and-branch relocation of substantial capital investments is significantly less common than the exponents of hyper-globalisation assume, in part because the costs to investors can be substantial. In addition, such investments can be tied to particular places by the availability of important forms of skilled labour, the need to collaborate closely with key suppliers, and the desire to access certain markets.

This picture of a far from frictionless investment universe has been confirmed by research which examines actual investor behaviour. A study of the geographical distribution of foreign direct investment from the United States found that when it came to making location decisions between developed economies investors prioritized direct market access and proximity, followed by the quality of education and skilled labour in the host country[9]. That the location decisions of international investors are guided by a mix of complex factors which include, but cannot be reduced to, company tax rates has been confirmed by a range of other research[10].

Such analysis provides an important corrective to those models of the relationship between tax and investment which assume a high or perfect degree of capital mobility. Such assumptions, while often presented as merely a technical means to facilitate model- building, have profound political consequences in attributing a degree of power to investors to shape economic policy that they do not in fact have. It may be politically convenient for some to present contemporary globalisation as an all-powerful external constraint on domestic policy formation – but it is a view not supported by the detail of what has been happening in tax policy in recent years.

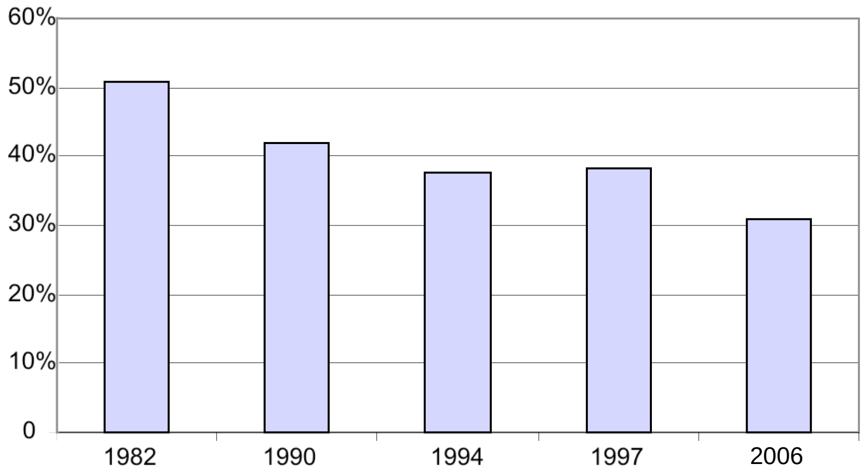
[9] W.N. Cooke and D.S. Noble (1998) 'Industrial Relations Systems and US Foreign Direct Investment Abroad', *British Journal of Industrial Relations*, Vol. 36 (No.4), pp. 581-609.

[10] See for example Cox, K. (ed.) (1997) *Spaces of Globalization* (Guilford: New York) and Weiss, L. (ed.) (2003) *States in the Global Economy* (CUP: Cambridge).

6. Company Tax Trends

If the world came close to resembling the hyper-globalisation model discussed above then we would expect to find evidence of a convergence in company tax rates around a 'race to the bottom' as countries compete for hyper-mobile and tax-dependent investment capital by slashing or abolishing company rates and the revenues they generate. That countries are engaged in aggressive tax competition, and this is resulting in falling rates and revenues, is simply assumed in much popular commentary on tax policy. However, the figures tell a more complex story.

Figure 1: OECD statutory corporate income tax rates (selected years)[11]



It is clear from Figure 1 that headline average unweighted statutory company tax rates have fallen significantly since the early 1980s. For the 17 countries from which the averages have been calculated, which cover the leading industrial economies for which data was available in the early 1980s, the average rate has fallen from 50.9 per cent in 1982 to 30.8 per cent in 2006. The most rapid declines took place in the 1980s, followed by a period of relative stability in the 1990s, before falling again in the early 2000s.

However, the GDP weighted average reports a less dramatic decline over the period, from 50.1 per cent to 36 per cent. The difference between the unweighted and weighted trends reflects the fact that smaller countries tended to reduce their headline rates more than the larger economies.

Both sets of averages mask some important and telling complexities.

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11 The table reports average unweighted corporate income tax rates for the 17 OECD countries for which tax rate data was available in 1982. This group includes Australia. Source: OECD (2007) *Fundamental Reform of Corporate Income Tax* (OECD: Paris).

Firstly, there remain considerable variations in statutory rates between the leading industrial countries. While Japan and the United States had rates of nearly 40 per cent in 2006, Australia and the UK were both at 30 per cent, while Denmark and Austria were 25 per cent each. So while average rates have fallen the extent to which particular countries have cut their rates has varied significantly. In fact the OECD has noted that the degree of variation between countries (measured by the standard deviation) increased slightly between 2000 and 2006, suggesting that a small but counter-intuitive pattern of divergence was evident. In sum, after over three decades of intense global economic restructuring there is little evidence as yet of a uniform 'race to the bottom' in pursuit of some ideal low tax rate that will supposedly guarantee competitive success.

Secondly, there is no consensus among researchers about why company tax rates have been falling. It is sometimes argued by advocates of the 'tax competition hypothesis' that the cuts have been driven by global competitive pressures as states vie for foreign direct investment. However, the evidence for this is unclear, in part because it is difficult to identify clear and consistent causal policy processes across a large number of diverse national political systems. Furthermore, we know from studying investor behaviour that tax rates do not necessarily determine their location decisions. Some research has argued that at least some of the cuts in rates over the past 30 years must be attributed to a changing intellectual climate in which key political and policy actors adopted the view that lower tax rates were desirable rather simply being a necessity imposed by external pressures[12].

Thirdly, while headline tax rates have been falling in recent years the revenues from taxing companies in most OECD countries have kept pace with, or sometimes exceeded, the growth in GDP and in revenues from other taxes. From 1982 to 2004 taxes on corporate income as a percentage of GDP decreased only in Japan, the UK, Italy and Germany[13]. Table 1 (below) presents company tax/GDP data for the years 2002 until the global financial crisis began in 2008 - a period during which average headline rates were falling.

The first point to note is the relatively large proportion of GDP assumed by taxes on corporate income in Australia compared to the other countries listed – with the notable exception of Norway. This is due to a mix of factors, in particular our dividend imputation system. This system acts to avoid taxing Australian company profits twice, first at the level of the company and then at the level of the individual taxpayer when profits are distributed as dividends. Instead, individuals receive credits for taxes paid by the company. Other countries effectively tax profits twice: once in the hands of the company, as corporate income tax, and once in the hands of the shareholder, at his or her full marginal tax rate. Because Australia does not do this, a simple comparison of the corporate income tax revenue as a proportion of GDP provides a somewhat misleading indication of the overall level of tax on profits across countries.

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12 More detailed discussion of this issue is provided by Loretz, S. (2008) 'Corporate taxation in the OECD in a wider context', *Oxford Review of Economic Policy*, Vol. 24 (No. 4), pp. 639-660.

13 OECD (2008) Policy Brief: Reforming Corporate Income Tax (OECD: Paris), pp. 3-4.

Also relevant is the particularly strong performance of the corporate sector in Australia. Over the period covered in Table 1, the profits share of national income rose from 24.3 per cent (March quarter 2002) to 29.3 per cent (June quarter 2008).[14] It is to be expected that corporate income tax would rise if profits rise, as a proportion of GDP.

Two points are important here. Firstly, over the past decade Australia has experienced a significant minerals-related boom. Norway has experienced significant growth based on oil. In the context of Table 1 this helps to explain why company taxes in Australia and Norway assume a noticeably larger proportion of GDP than the other countries listed. Secondly, the strong performance of Australia's corporate sector, and not only the resources sector, has taken place despite tax rates that many in business currently allege are undermining Australia's competitiveness.

Table 1: Taxes on corporate income as a percentage of gross domestic product

	2002	2003	2004	2005	2006	2007	2008
Australia	5.0	5.0	5.5	5.8	6.4	6.8	5.9
Canada	3.2	3.3	3.6	3.5	3.8	3.5	3.3
France	2.9	2.5	2.8	2.4	3.0	3.0	2.9
Germany	1.0	1.3	1.6	1.7	2.1	2.2	1.9
Japan	3.2	3.4	3.7	4.3	4.7	4.8	3.9
Netherlands	3.3	2.8	3.1	3.8	3.3	3.2	3.2
New Zealand	4.2	4.6	5.4	6.2	5.7	5.0	4.4
Norway	8.1	8.0	9.9	11.8	13.0	11.4	12.5
Sweden	2.3	2.4	3.0	3.7	3.6	3.7	3.0
United Kingdom	2.8	2.7	2.8	3.3	3.9	3.4	3.6
United States	1.7	2.1	2.5	3.1	3.4	3.0	1.8
OECD	3.2	3.1	3.3	3.6	3.8	3.8	3.5

Source: OECD (2010) Revenue Statistics: comparative tables, OECD Tax Statistics

[14] ABS 2011, Australian National Accounts: National Income, Expenditure and Product, Cat. No. 5206.0, Table 20, Trend.

More generally, in the majority of countries listed, and at the level of the OECD as a whole, company taxes as a percentage of GDP were higher in 2008 than they were in 2002. Among the reasons for this combination of falling rates and rising revenues has been ‘base broadening’: reducing the scope of deductions, exemptions and allowances that companies can claim to reduce their overall tax bill. Because of such measures the fiscal impact of company tax reform in many OECD countries has been often been revenue-neutral or revenue-positive.

However, base broadening measures have been a key feature of company tax policy for nearly three decades. In some OECD countries it is unclear to what extent base broadening can continue to secure revenue neutral outcomes in the event that rates continue to fall.

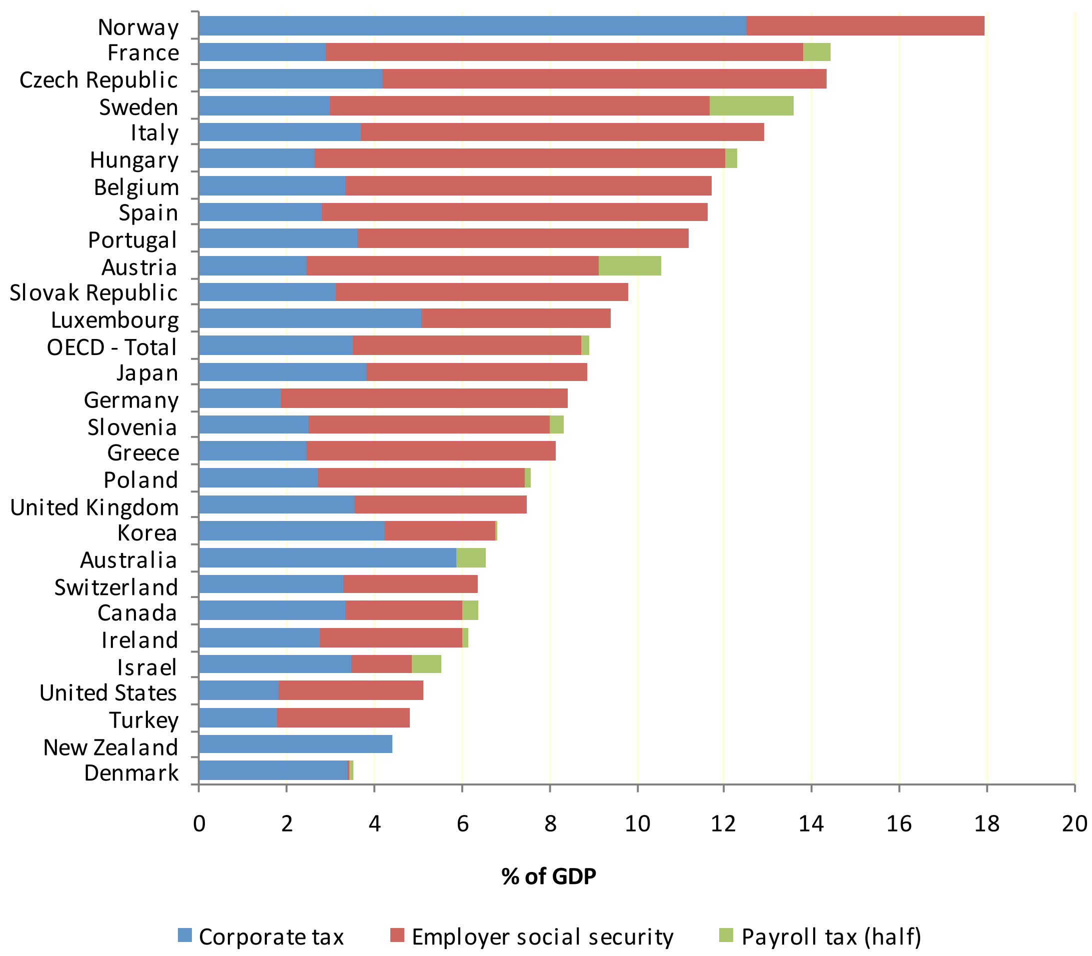
But the data presented in Table 1 must also be understood in the context of the taxes that companies in Australia *do not pay*. Figure 2 (below) illustrates the corporate, employer social security and payroll taxes that corporations had to pay as a proportion of GDP in OECD countries in 2008 (the latest year for which data is available).

In sharp contrast to the large majority of other OECD countries companies in Australia do not pay social security contributions. When this is taken into account the tax burden on companies in Australia is considerably less than that implied by comparing headline statutory rates or company tax/GDP ratios.

Finally, and related to the above discussion of base broadening, it is important to distinguish between headline rates and the rates that apply to companies once complex sets of rules relating to allowances and deductions have been applied. Recent research, using firm-level financial statements, has sought to estimate the effective tax rates that domestic and multi-national companies pay in a number of countries. Some of the findings are presented in Table 2.

This data supports a number of conclusions. Firstly, as with headline rates, there is considerable diversity between countries in terms of effective rates. For example, multi-nationals face an effective rate of 28 per cent in the United States compared to 36 per cent in Japan and an average of 21 per cent at a European level. There is therefore little evidence that diversity in statutory rates is masking a convergence and a ‘race to the bottom’ in effective rates. Secondly, the effective rate of 22 per cent for both domestic and multi-national firms in Australia is broadly in line with the effective rates across Asia, Europe and Latin America. To the extent that such rates can be argued to shape investment decisions there appears to be little reason to conclude that current company tax arrangements by are by themselves placing Australia at a competitive disadvantage.

Figure 2: Taxes on corporations as a proportion of GDP in 2008



Source: OECD (2008) Revenue Statistics: comparative tables, OECD Tax Statistics

Table 2: Effective & Statutory Tax Rates on Domestic (DOM) & Multinational (MNAT) Companies 2005-2009

		Mean Effective Tax Rates	Statutory Tax Rates
Australia	DOM	22	30
	MNAT	22	30
France	DOM	25	35
	MNAT	23	35
Germany	DOM	16	37
	MNAT	24	37
India	DOM	22	34
	MNAT	17	34
Japan	DOM	37	40
	MNAT	36	40
United Kingdom	DOM	20	30
	MNAT	24	30
United States	DOM	23	39
	MNAT	28	39
Asia	DOM	21	32
	MNAT	18	31
Europe	DOM	21	23
	MNAT	21	29
Latin America	DOM	21	30
	MNAT	24	28

Source: Adapted from Table 1 in Markle, K.S. and D.A. Shackelford (2011*) Cross-Country* Comparisons of Corporate Income Taxes (NBER: Cambridge, MA)

In sum, the picture that emerges from the research and data discussed above is one of enduring variation and complexity in how companies across the world are taxed. While business commonly cites a vaguely defined 'globalisation' as a reason why rates must come down, the evidence suggests that in reality governments around the world continue to regard revenues from company tax as an important component of national income whose contribution to their fiscal bases should be preserved. As a means to this end, governments across Europe, Asia and North America continue to exercise more policy discretion in relation to setting nationally-specific statutory and effective rates than the prophets of hyper-globalisation assume is possible under conditions where flows of investment are asserted to have become highly tax-sensitive.

7. Tax & Competitiveness

A more useful way to think about company tax and its relationship to investment and growth is to see it as part of the total package of costs that companies consider when deciding the quantum and location of investment. As research indicates, companies eager to access particular consumer and labour markets are unlikely to decline such access because their company tax bill is marginally higher in one country than it is in another. The relationship between tax, location and profitability is considerably more complex than that.

Nevertheless, government should be concerned about how the tax system relates to investment and growth. But instead of attributing excessive significance to company tax, which the Henry Tax Review panel appeared to do, a more rounded consideration of how tax interacts with competitiveness is needed.

One approach, developed by KPMG, has been to develop an index of tax competitiveness that combines measures of all the main taxes that business faces in 10 countries. The resulting Total Tax Index (TTI) is a measure of the total taxes paid by corporations in a particular location expressed as a percentage of total taxes paid by corporations in the US. The US therefore has a TTI of 100.00 which constitutes the benchmark against which the other locations are scored. KPMG complemented their TTI with a measure of the Total Effective Tax Rate. The final rankings of countries based on both measures were the same.

KPMG's results for 2010 are presented in Table 3 (below). In terms of 'total tax competitiveness' Australia ranks fourth – ahead of the UK, the US, Germany, Italy, Japan and France. Australia maintained its fourth place ranking from the 2008 results while countries such as the US, Japan and the Netherlands slipped down.

Broken down into 41 international city locations the KPMG research found that Melbourne ranked ninth while Sydney ranked eleventh – both ahead of cities such as London, New York, Los Angeles, Frankfurt and Tokyo. When 'effective corporate income taxes' are isolated within the analysis and then ranked, Australia is the third most competitive, ahead of all the other countries except Canada and France.

Table 4 (below) presents the results when the tax costs for research and development activities are isolated and ranked. Research and development plays a particularly important role in driving growth, innovation and global competitiveness. It is therefore common for R&D operations to be given special tax treatment by government with the aim of attracting new and long-term investment in such activities.

The KPMG analysis ranks Australia first among the ten countries (having been placed fifth in 2008). In the context of the 41 international city locations Melbourne is ranked first while Sydney is ranked third.

Quantifying the total tax costs faced by investors does not lead us to a final ideal model of the causal relations between taxation, investment and location. But it does make an important contribution to our understanding of what those relations may be. In this instance the KPMG research suggests that, in many important respects, Australia is already a highly competitive economy in terms of how our tax architecture interacts with investment. At a general economy level it has performed consistently well in recent years and is now one of the leading countries in terms of how its tax system encourages vitally important investment in research and development.

Table 3: KPMG Total Tax Index 2010 and 2008 (all taxes)

Rank	Country	Total Tax Index			2008 Rank
		2010	2008	Change	
1	Mexico	59.9	70.2	-10.3	1
2	Canada	63.9	78.8	-14.9	3
3	Netherlands	76.4	78.3	-1.9	2
4	Australia	80.8	95.9	-15.1	4
5	United Kingdom	88.0	101.6	-13.6	6
6	United States	100.0	100.0	0.0	5
7	Germany	124.1	128.2	-4.1	8
8	Italy	129.6	172.0	-42.4	9
9	Japan	138.0	120.8	17.2	7
10	France	181.4	185.3	-3.9	10

Source: KPMG (2010) *Competitive Alternatives 2010: Special Report Focus on Tax* (KPMG LLP)

Table 4: KPMG Total Tax Index 2010 and 2008 (Research & Development)

Rank	Country	Total Tax Index	2008 Rank
1	Australia	12.1	5
2	Canada	29.3	2
3	United Kingdom	36.5	3
4	Netherlands	50.7	1
5	Mexico	71.5	4
6	United States	100.0	7
7	France	115.6	9
8	Japan	130.6	6
9	Germany	154.3	8
10	Italy	209.1	10

Source: KPMG (2010) Competitive Alternatives 2010: Special Report Focus on Tax (KPMG LLP)

8. Concluding Comments

This discussion paper has argued against the emerging view among some that companies should not pay any tax, as well as challenging assertions made by many in Australian business that globalisation necessarily means companies must pay less.

It is right that companies, as distinct legal entities that benefit from some important legal privileges, be required to make a contribution toward paying for the services and labour skills that make their profits possible.

Furthermore, there is evidence that the current tax arrangements for companies in Australia are already highly competitive. There is no global imperative that means rates must come down and the quantum of revenues potentially fall.

Of course Australia must prepare for the future. But it must be one based on a community with the education, skills and infrastructures that will ensure Australia continues to be among the most attractive places on the globe to both live and invest. There is no evidence that we need to participate in a competitive 'race to the bottom' to secure such a future.

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