SUBMISSION ON THE TAXATION OF COMPANIES

INTRODUCTORY

This supplementary submission deals with aspects which are mentioned in sections 2.4, 3.1, 4.1 and 8.3 of the architecture paper.

BACKGROUND

The stark reality is that any taxes nominally imposed on a corporate entity are ultimately borne by individuals. Market forces mean that in practice there is little scope for squeezing customers, employees or suppliers. That leaves only shareholders and proprietors.

Those commentators who for philosophical reasons from time to time urge higher taxes on businesses invariably overlook this important point.

Companies are not actual "persons", except by way of legal fiction. Wealth is really owned only by human beings, either directly or indirectly.

Clearly, all the profits of a company, whether distributed or not, morally and economically "belong" to the shareholders. In the context of the type of sliding scale income tax system being used in this country such profits should accordingly be taxed in the hands of individual shareholders at their marginal rates, irrespective of whether these were higher or lower than the current company tax rate.

A SIMPLE CHANGE

One easy way of doing this would be to extend the current rules and principles applying to the taxation of partnerships also to the taxation of companies. This would remove the anomalies in the present system, as well as greatly simplifying it. It would also reflect the reality that in an economic sense companies are indeed already partnerships.

There would be much greater transparency and confusing expressions such as "imputation credits" could disappear from the vocabulary. Furthermore, such an approach would allow the benefit of any tax losses to be passed on to the investors at the time the losses were incurred. This would be a worthwhile change - at least from the perspective of investors.

Franking accounts would also go. This concept of a major company asset which has to be recorded on paper but which cannot be included in a balance sheet has always been an accounting oddity.

A reform on the above lines would in addition remove any incentive for Australian companies to relocate themselves overseas.

The intriguing question emerges as to why this simple way of eliminating the previous quite unjustified double taxation of company profits was not enacted in the first place.

These changes would probably be roughly revenue neutral, as the current 30 per cent company tax rate on undistributed profits would be being exchanged for personal marginal income tax rates ranging from nil to 46.5 per cent.

Under the imputation system distributed profits are already effectively being taxed at these marginal rates, with company tax merely acting as a withholding tax.

However, even if the changes did not result in strict neutrality the correct remedy would be to adjust the rate, not to continue using a cumbersome and inequitable system.

PAYG ASPECTS

If the government wanted to collect its revenue concurrently with the actual payment of dividends then this could readily be accommodated through a system of group certificates or their electronic equivalent.

A simple approach would be to deduct tax at, say, 20 per cent for all shareholders who supply a tax file number and at the top marginal rate in the system for those who do not. Credit for these instalments could then be given at the time of assessment, on the lines used for pay as you go (PAYG) salary deductions.

RESOURCE ALLOCATION

As a separate issue, the opportunity could also be taken to forcefully encourage companies to distribute to the hilt. This would be desirable for economic and efficiency reasons unconnected with tax.

This could, for example, be done by taxing undistributed profits tax at a higher rate than suggested above - say, at 66 per cent, which is the penal rate applied to the income of minors. This would be a final rate, not a withholding rate, but if the after tax undistributed profits were to be distributed in a subsequent year then they would be treated as exempt in the shareholders' hands.

Companies sometimes regard profits retained in the business as a source of cheap capital. It would be far healthier for the nation and it would lead to a better allocation of resources if all profits were in the first instance paid out to the shareholders to whom they morally belong.

These could then make their own investment decisions as to whether to put the money back into the same company or to deploy it elsewhere. Any company wanting extra capital should have to justify this to the market, instead of just passively and paternalistically hanging on to the plough-back.

TRUSTS

Some years ago the then Treasurer, Peter Costello, announced that in future all trusts would be taxed as though these were companies. To the relief of many people this proposal was subsequently abandoned.

This original decision had been based on advice from the Ralph Committee on Business Taxation. However, with respect, that committee got it wrong.

It paid considerable attention to the need to reform the way different types of entity were being taxed in Australia - a perfectly valid view - but it missed the point.

In one of its earlier papers the committee, advocating a level playing field, had said: "It does not make sense for exactly the same investment to attract very different tax treatment simply because it is put through a trust rather than a company. Such a result violates the tax principle that taxpayers in similar positions should be treated similarly."

From this logical starting point the committee then went on to suggest that trusts should be taxed as though they were companies - a view already favoured by the Taxation Commissioner.

However, it would be much more equitable to eliminate the present anomalies by reforming the system the other way round. If anything, companies should be taxed as though they were trusts - although, as discussed above, taxing them as though they were partnerships would be even better.

CONCLUSION

Taxing companies as either trusts or partnerships would also have one further advantage for the community - it would eliminate the incentive for high income earners to incorporate themselves just to benefit from the lower company tax rate.

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