The Tax Institute

29 September 2025

Ms Danielle Wood
Chair
Productivity Commission
Level 8, Two Melbourne Quarter
697 Collins Street
Docklands VIC 3008

By email: 5pillars@pc.gov.au

Dear Ms Wood,

Interim report: Creating a more dynamic and resilient economy

The Tax Institute welcomes the opportunity to make a submission to the Productivity Commission in respect of its interim report following the consultation on Pillar 1: creating a more dynamic and resilient economy (**Interim Report**).

We acknowledge the importance that our tax system has to play in promoting productivity and economic growth. We are pleased that the door appears to be opening to changes to our current tax system that are necessary to enhance productivity and create a more dynamic and resilient economy.

In the development of this submission, we have consulted with our National Technical Committees to provide feedback that is representative of our broader membership.

Our comments in this submission focus on the role of the taxation system in shaping the Australian business landscape and fostering productivity and economic growth. We have addressed the proposed tax measures and answered the Productivity Commission's information requests. We do not address the aspects of the Interim Report relating to regulation.

In summary, although The Tax Institute commends the Productivity Commission for proposing some significant changes to our current unsatisfactory corporate tax system, we are concerned that the proposal as set out in the Interim Report will largely add new layers of complexity, rather than reforming the already complex existing tax system. Introducing a new tax, the proposed net cashflow tax, without abolishing other inefficient taxes or making other reforms to simplify the system will increase complexity in our tax system. We do not support this approach without accompanying reforms.

We welcome the opportunity to consider and contribute to any meaningful proposal for tax reform. Superficial, narrow, or ad hoc legislative amendments are inefficient, leading to greater complexity and uncertainty for all Australians and undermine the fundamental principles of good tax policy and law design. We recognise that this consultation is focused on corporate tax, and the Interim Report contains proposals that, if adopted, would be quite substantial. However, we consider that it will be necessary in due course to review other aspects of the broader system and Australia's overall tax mix. We would caution against making changes to one aspect of the system without due consideration of the broader implications.

Our 2021 landmark discussion paper, Case for Change, identifies the aspects of the Australian tax system that are performing well and those that are lacking. Looking at the system holistically, it proposes a range of options for reform aimed at stimulating investment to enhance Australia's productivity growth, reducing the compliance burden on taxpayers and ensuring a fairer system for all Australians. A bold tax reform strategy is essential for supporting Australia's economy and communities, now and in the future.

The Tax Institute has also recently released its Incoming Government Brief: June 2025 (**the Brief**), detailing key tax and superannuation measures announced by previous governments that remain unenacted before the 48th Parliament. It also identifies important measures not yet announced by the Government that we consider require prompt attention. The Brief aims to assist the Government to prioritise essential tax and superannuation measures, and in some cases, suggests amendments and further consultation before certain measures progress.

The Tax Institute made a submission on the Productivity Commission's initial consultation on Pillar 1: Creating a more dynamic and resilient economy, which considered the role of the taxation system in shaping the Australian business landscape and fostering investment and productivity growth.

Our detailed response and recommendations are contained in **Appendix A**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more information about The Tax Institute.

If you would like to discuss any of the above, please contact our Tax Counsel, John Storey on (03) 9603 2003.

Yours faithfully,

Julie Abdalla
Head of Tax & Legal

Tim Sandow
President

APPENDIX A

We have set out below our detailed comments and observations on the tax recommendations from the Interim Report below.

Preliminary comments

The Tax Institute is pleased that the Productivity Commission has acknowledged the need to reduce Australia's reliance on the current, inefficient company tax system in order to improve Australia's dynamism and resilience. Well considered ideas and bold proposals are what Australia's tax system needs. However, we are concerned that this proposal will greatly add to an already complex corporate tax system. Any potential productivity gains that may accrue from shifting some revenue generation away from the current corporate income tax to the new proposed net cashflow tax could be undone by adding an even higher compliance burden on businesses.

We have long advocated for changes to Australia's corporate tax system, including in our Case for Change discussion paper where we discussed the benefits associated with a single tax rate across all companies of no higher than 25%. The Tax Institute supports the Productivity Commission's recommendation that the tax rate be reduced to 20% for all companies with revenues below $1 billion. However, this approach still results in a dual corporate tax rate which adds complexity to the Australian corporate tax system. At a minimum, it should be a longer-term goal to return to a single, lower, corporate tax rate.

The Tax Institute does not oppose the introduction of new taxes in principle, and acknowledges the potential advantages of a cashflow tax over the current income tax model, as identified in the Interim Report. However, we do not support the introduction of entirely new additional taxes without wholesale reforms to simplify Australia's tax system. We note that the Interim Report makes reference to the Australia's Future Tax System Review (2010) final report (**the Henry Review**) when describing how the net cashflow tax may be less distortionary than the company income tax. However, the Henry Review, upon recommending a cashflow tax, states that:

> a broad-based cash flow tax could be used to **finance the abolition of other taxes**, including payroll tax and inefficient State consumption taxes. Such a tax would also provide a sustainable revenue base to finance future spending needs.[1]
>
> [emphasis added]

In the Interim Report, the only proposed change to the current tax system is a reduction in the corporate tax rate for some taxpayers. Businesses that operate in Australia will continue to face all the same compliance obligations that they currently do under our existing corporate tax system. There are no proposals in the Interim Report to simplify the current system. Even if the new net cashflow tax were to be well designed and implemented, and made as simple as possible, it is still an entirely new tax. Introducing a new tax to the existing system will necessarily add complexity to the current system, especially upon its implementation, but also on an ongoing basis. This proposal will add to the compliance burden of taxpayers on top of their existing compliance obligations.

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[1] See page 273 of volume 1 of the Henry Review.

We consider that the introduction of a new tax should not be implemented without the abolition of other inefficient taxes and/or in conjunction with other reforms to simplify the system. As described in the Henry Review, revenue generated from a broad-based net cashflow tax could support the abolition of inefficient taxes. Additionally, our Case for Change report makes a strong argument for the abolition of other inefficient state-based taxes, such as insurance levies and stamp duties. Alternatively, reforming or simplifying other taxes such as the fringe benefits tax can come at some cost to revenue, which this new tax could be used to help fund broader reforms elsewhere in our tax system. The complexities for businesses that are associated with current inefficient taxes would be removed, and if the new net cashflow tax is well designed, the net result will be a reduced compliance burden and improved economic efficiency.

We address the tax recommendations in the Interim Report in more detail below.

Addressing the draft tax recommendations

1. Corporate tax reform to spur business investment

1.1. Pivot the corporate tax system to a more efficient mix of taxes

Draft recommendation 1.1 proposes to make the corporate tax system more efficient by moving towards a system with a lower company income tax combined with a new net cashflow tax.

The Tax Institute supports the Productivity Commission's view that the Australian corporate tax system should be made more efficient. However, this should not focus on solely the reduction of rates and the introduction of new taxes. The Tax Institute considers that further action must be taken to ensure that Australia's tax system is more efficient, through holistic reform and the abolition of inefficient taxes. The recommendations set out in the Interim Report are a good starting point, but on their own may make the current system worse. We encourage the government to consider further opportunities to improve our tax system.

While the lowering of the corporate tax rate to 20% for companies with a turnover of less than $1 billion is welcomed, it does not reduce the compliance burden for any of those businesses. Whether the corporate income tax rate is 30% or 20%, or any other rate, does not change the compliance burden.

This recommendation would place slightly less emphasis on the corporate income tax as a revenue generating measure. However, the reduction in corporate income tax revenue would be largely replaced by the proposed introduction of the net cashflow tax. Therefore, the tax burden on most Australian companies would not materially change. The shift from income tax to a cashflow tax is argued to have various economic efficiencies (in particular, promoting greater business investment) but we are concerned that any productivity gains would be undone by virtue of the fact that the overall system will be more complicated.

The Tax Institute suggests that the addition of a new net cashflow tax should go hand in hand with the removal of inefficient taxes to reduce the compliance burden on businesses, and other changes to make the Australian corporate tax system more efficient. As mentioned above, we support the idea of a new tax, only where it funds the abolition of inefficient taxes and/or is accompanied by other reforms to simplify the current system.

1.2. Lower the headline company tax rate to 20%

Draft recommendation 1.2 suggests lowering Australia's headline company tax rate to 20% to increase investment by increasing retained earnings, attracting foreign capital into Australia, and boosting the after-tax return companies receive on their investments. The company tax rate for Australia's largest companies, with turnover above $1 billion, would remain at 30%.

The Tax Institute supports the lowering of the company tax rate, as stated in both our initial submission to this inquiry, and our Case for Change paper. However, we suggest that the lower corporate tax rate should be applied to all businesses to avoid the complications associated with a dual corporate tax system.

The Tax Institute has long advocated that a single, lower rate, no higher than 25%, should apply to all companies, irrespective of their aggregated turnover or proportion of passive income. The dual system has added a range of complexities to an already complex system. It produces anomalous outcomes, particularly because a company can oscillate between the two rates from one year to the next. It also raises productivity concerns where a business that is in a position to increase its turnover would be subjected to a higher income tax rate that would apply to all of its income, thereby leaving that business worse off despite better overall performance.

At a minimum, The Tax Institute considers that it should be made clear that the eventual goal is to return to a single income tax rate for all companies and that this change is a step in that direction. This should be accompanied with clear timeframes for when that goal will be achieved. Further, we note that maintaining the suboptimal situation of having two corporate income tax rates would be easier to justify (as a temporary measure) if the other simplification proposals we have made in this submission were adopted, such as abolishing inefficient taxes.

We note that the Productivity Commission has not yet formed a view on whether the higher tax rate for companies with turnover above $1 billion should be phased in or not. While The Tax Institute considers a uniform company tax rate to be a better outcome for the corporate tax system, if there are different tax rates then we consider that there is merit in gradually increasing the corporate tax rate as turnover increases, rather than relying on a single threshold. This way, the increase from the lowest proposed tax rate of 20% that will apply to most companies does not jump to 30% if a company's turnover exceeds $1 billion in a year by even a single dollar. This reduces the likelihood that businesses are disincentivised from increasing their revenue in an attempt to remain on a lower tax rate and also minimises the inequity of a higher turnover leaving a taxpayer in a worse net result.

For example, the lowest proposed corporate tax rate of 20% could be increased by 1% as turnover increases in $50 million increments starting at $750 million turnover. Therefore, a company with turnover between $750 million and $800 million would pay tax at 21%, between $800 million and $850 million it would pay 22% and so on until the top rate of 30% applied for companies with turnover over $1.25 billion. So in effect, the tax rate would gradually increase within a band between $750,000 and $1,250,000 turnover, instead of a 10% jump upon exceeding a single $1 billion threshold.

This would help prevent businesses being disincentivised from increasing turnover and minimise the desire to engage in tax planning opportunities to prevent being subject to the higher rate. Economic modelling should be undertaken to determine an optimal phase-in rate.

Of course, a phased approach to the corporate tax rate may introduce a different form of complexity and confusion for businesses. This is why we maintain our view that a single tax rate is the optimal position for the tax system as a whole.

1.3. Introduce a net cashflow tax of 5%

Draft recommendation 1.3 suggests introducing a net cashflow tax of 5% to be applied to a company's net turnover. A net cashflow tax would allow companies to deduct the full capital expenditure costs from their profits in the year those expenses are incurred.

The Tax Institute has long advocated for a broad-based consumption tax, as outlined in our Case for Change. A tax on net turnover as proposed here is broadly similar to a consumption tax, so we support the premise of this new tax in theory. However, this is only if it is part of a package that abolishes existing inefficient taxes that are costly and timely to comply with. The abolition of these outdated taxes could be funded by the introduction of the cashflow tax.

Accordingly, while The Tax Institute does not dispute that the net cashflow tax would be efficient, improve compliance, and generate revenue, we do not support the introduction of a new tax without holistic tax reform. We are concerned that introducing the proposed net cashflow tax would simply increase the compliance burden on businesses.

The Tax Institute commends the Productivity Commission on the reasoning behind the introduction of the net cashflow tax and identifying its many positive characteristics compared to the current income tax model. However, we recommend that consideration be given to the inefficient taxes that could be abolished in line with the introduction of a new tax to further enhance productivity, and to identifying other ways in which the existing system can be simplified. Doing so would contribute to streamlining our current complex tax system, rather than exacerbating it, and would better enable businesses to comply and improve productivity within Australia.

Addressing the information requests

Information request 1.1 — The PC is interested in views on further information about the interaction between the proposed cashflow tax (i.e. the net cashflow tax) and Australia's dividend imputation system

The Tax Institute considers that the net cashflow tax should fall within the dividend imputation system. Doing so will ensure the integrity of the dividend imputation system. The dividend imputation system is designed to eliminate double taxation on dividends, which would effectively occur if tax were to be paid on net cashflow, and then again by shareholders on receipt of dividends.

The issues that arise from taxing entities at different 'levels' (such as at the company and shareholder levels) is common across most tax jurisdictions. Internationally, different approaches are adopted to address this. In some countries (such as Singapore) dividends are exempt from tax, so corporate income tax acts as a final tax. This approach is inconsistent with a progressive tax rate system, as in effect all shareholders pay tax at the same rate, regardless of their respective overall incomes. Some countries (such as the United States) accept a degree of double taxation, usually in conjunction with a lower tax rate that applies to dividends. This can be distortionary as the net effect at the shareholder level will usually differ to how other income is taxed (that is, the effective tax paid on dividends will be more or less than other income depending on the circumstances).

Australia's dividend imputation system avoids these problems by taxing dividends at ordinary rates of tax but offering a full credit for any company tax that has been paid in most situations. This preserves the progressive nature of Australia's tax rates and offers greater tax neutrality between different types of income or business structures.

The Henry Review acknowledged the benefits of Australia's imputation system. It confirmed that dividend imputation enables a more neutral treatment between incorporated and unincorporated businesses, and has less impact on company financing and distribution choices compared to the pre-imputation regime that applied before 1987.[2] It also encourages business investment by reducing the cost of capital for domestically owned companies.

The Henry Review also describes Australia's imputation system as a way to ensure integrity, and reduce the need for anti-avoidance rules in Australia. Relevantly, it provides that:

> …[t]he **benefit to companies and their shareholders of avoiding or deferring company income tax is therefore reduced**. This can **increase company income tax revenues and reduce the need for anti-avoidance rules in general**.[3]
>
> [emphasis added]

[2] See page 192-195 of volume 1 of the Henry Review.

[3] See page 194-195 of volume 1 of the Henry Review.

One of the costs of these benefits is that Australia's imputation system is extremely complex, needlessly so in many cases. Although the imputation system could be reformed to be simpler, a degree of complexity is likely to be inevitable in order to maintain the benefits it offers, that is, maintaining tax rate progressivity and greater neutrality between different types of income. However, these benefits are likely to be undermined if a new cashflow tax is not included in our imputation system. A portion of company profits would be taxed twice, as net turnover by the company and as a distribution of profits to the shareholder. This may result in adverse consequences in terms of economic distortions, undermining tax rate progressivity, and creating incentives for tax planning. Yet there will be no corresponding benefits in terms of simplification, as the existing imputation system will remain in place, unchanged.

We consider that this would run the risk of being the worst of both worlds, undermining many of the benefits of our current imputation system, while retaining all the complexity of that system (or potentially making it worse). We strongly recommend that the net cashflow tax be included within the scope of the dividend imputation system to ensure the ongoing integrity of the system, and avoid double taxation on company profits.

We note that the ability to frank tax paid under the net cashflow tax will be complicated if there is a phase in approach to the higher tax rate, as proposed above, in that some taxpayers within that band may vary each year. We reiterate that this is another reason why having multiple tax rates is not beneficial, as it further complicates the franking system. If a phase in approach to different tax rates does apply, we consider that taxpayers under $1bn should be able to frank distributions at 30%, and those over $1bn should be able to frank at 35%.

Information request 1.2 — The PC is interested in views on the most appropriate way to tax financial services in a manner that is consistent with the proposed changes and induces additional capital expenditure in a similar manner to the net cashflow tax.

The proposed net cashflow tax has some shared characteristics with Australia's goods and services tax (**GST**), which is similarly a tax on net 'turnover'. The issues that arise regarding taxing interest and other forms of financial supply were well canvassed when the GST was introduced, in particular, that financial supplies did not represent 'value added'. The conclusion was to exempt financial supplies from GST, and instead treat them as input taxed (that is, deny credits for related acquisitions).

It would seem incongruous that an appropriate way could be found to tax financial services institutions under a net cashflow tax, where one could not be found in respect to the GST. The issues involved are complex. If the government proceeds with a net cashflow tax, The Tax Institute recommends that a detailed review be undertaken of the overall tax arrangements that apply to the financial services sector to consider the most appropriate tax settings.

We note, however, that if a special, modified net cashflow tax applies to the financial sector only, which might be substantially different to a cashflow tax that applies more broadly, this approach would likely add even more complexity to Australia's corporate tax system.

Information request 1.3 — The PC is interested in views on whether a phased or package approach to the proposed changes is preferable, and the lead time government and companies would need.

The Tax Institute considers that a phased approach to implementation of the proposed changes to the corporate tax rate and the introduction of the new net cashflow tax would cause further complexity. It would also delay the realisation of the anticipated benefits outlined in the Interim Report. Previous significant changes to the tax system to introduce a new tax, such as the GST and the various other changes that accompanied the introduction of that tax, were implemented as one package, with appropriate transitional provisions in place for arrangements that had been entered into prior to the introduction of the GST. The introduction of the GST was broadly successful. Therefore, we recommend this model be followed if there are appropriate transitional arrangements in place and in the absence of a compelling reason to the contrary.

However, we would like to draw to the Productivity Commission's attention one issue that will cause unfairness for some taxpayers upon the introduction of a new cashflow tax. Companies that are base rate entities (that is, have turnover of less than $50 million per year and currently pay tax at 25%) may be disadvantaged if they have incurred capital expenditure prior to the introduction of these changes, and the depreciation of those assets continues afterwards. In such cases, where the tax rate for base rate entities decreases from 25% to 20%, those entities will 'lose' 5% of the value of prior capital expenditure not yet deducted at the time this proposal is introduced. However, because that expenditure was incurred prior to the introduction of the 5% cashflow tax, it will not be expensed against that tax. The net result will be that base rate entities that have undeducted capital depreciation (so it will exclude expenditure claimed under the instant asset write off provisions) will be worse off. This is an unfair outcome.

Subject to how material this issue is, it would warrant an appropriate transitional arrangement. This might involve a phase in approach to the introduction of the cashflow tax, which would ameliorate the timing differences involved. Or alternatively base rate entities could be entitled to deduct depreciation costs incurred prior to the change against the cashflow tax, as a temporary transitional measure, therefore rectifying the timing disadvantage. This later proposal would seem to be the least disruptive, given this is only an issue that will apply to certain taxpayers (base rate entities with undeducted depreciation incurred before the introduction of the proposed changes).

We qualify all of the above by stating that it is essential that such changes be implemented with sufficient time for extensive public consultation, and for businesses to prepare for the new change. The Tax Institute considers that these proposed changes should be implemented with no less than 12 months of lead time from the date that the relevant bill becomes law.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 9,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals