Further cuts in company tax cuts and resulting gifts to foreign investors

SUMMARY

A conservative estimate of the benefit to foreign investors of the move to give tax cuts to companies above a $50 million turnover will be $3.7 billion per annum when the cuts are fully phased in by 2026-27. For the decade beginning in 2026-27 the cost will be $45.4 billion. These figures are based on the conservative estimates presented below.

WORKINGS

If tax cuts are extended to companies with turnovers of $50 million or more there will be significant gains to foreign investors. Our aim here is to work out how much foreign investors will benefit from the tax cuts. Our method here is to focus on the benefits to foreigners via dividend payments.

The first hurdle we face in estimating how much foreigners benefit is that companies often pay dividends without necessarily paying tax. However, we can get around this hurdle by noting that companies that pay tax are able therefore to build up franking credits and so pay franked dividends. Hence we can examine how much is paid to foreign investors by way of franked dividends. (Foreigners cannot use franking credits of course but the company cannot stream franking credits to Australian shareholders: all shareholders receive franked dividends or not as the case may be.)

According to ATO data for 2015-16, companies in Australia paid franked dividends of $130.4 billion and unfranked dividends of $14.5 billion for a total dividend payout of $144.9 billion. Of the franked dividends the companies in the relevant ranges paid franking credits at the values given in Table 1.

Table 1: Total franked dividends paid by size of company ($ billion)

Less than medium – to $10 million	25.1
Medium – $10 million to less than $100 million	12.9
Large – $100 million to less than $250 million	5.7
Very large – $250 million or more	86.6
Total	**130.4**

Source: ATO Taxation Statistics.

Table 1 does not give the exact breakdown we need because instead of a category starting at a $50 million turnover, the relevant category goes from $10 million to $100 million. The procedure here is to assume that the franked dividends in the medium category are evenly split between the companies with a $10 to 50 million turnover and the remaining companies, those in the range $50 to 100 million.

On that basis using Table 1 data *franked dividends* on the part of companies with a turnover of $50 million or more would have been $99 billion. That $99 billion represents 68.2 per cent of *all* dividends (franked and unfranked). This ratio is important in the following considerations.

Balance of payments figures show dividends paid abroad were $46.4 billion in 2015-16. (ABS cat no 5302.0.) This figure includes dividends on direct and portfolio investments paid abroad.

If foreign investors received dividends from different sized companies in proportion to the total dividends by company size, and they received the same share of franked to unfranked dividends as the totals, then we would expect 68.2 per cent of dividends received by foreigners, or $31.7 billion, would represent franked dividends paid by companies both with turnovers of $50 million or more and that paid franked dividends. Recall that companies that pay franked dividends are the proxy here for companies that both paid tax and paid dividends.

That would imply that company tax of $13.8 billion[1] would have been paid on behalf of foreign investors with regard to the dividends paid by companies with turnovers of $50 million or more. If the company tax rate were to be reduced from 30 to 25 per cent then that particular tax amount would fall by $2.3 billion to $11.3 billion. If the companies concerned maintain their present payout ratio then the 'gift' to the foreign shareholders would also be $2.3 billion per annum.

[1] +$31.7 billion times 0.3(100/70).

These are conservative estimates. We expect foreign investors' holdings would be biased towards larger companies than is assumed here. While 2015-16 is the latest taxation statistics available, more recent figures are likely to show that we have used a temporarily low figure as the basis for our estimates.

Nevertheless, taking them at face value our results apply to 2015-16 data. Assuming that all corporate magnitudes grow in line with official GDP forecasts and projections,[2] then in 2026-27, when the tax cuts are fully implemented, foreign investors would be getting a gift of $3.7 billion per annum with respect to the company tax cuts for companies with turnovers above $50 million. In the decade beginning in 2026-27 the total gift to foreigners will be $45.4 billion.

There are other assumption used here that suggest the present figures are conservative. The ABS dividend figures may be under-reported relative to the tax office figures. The 'gift' figures are calculated only on the actual dividends paid but there are other benefits to foreign shareholders. Companies may also increase their retained earnings and that will be reflected in the market capitalisation of the companies concerned. When foreign shareholders buy and sell shares the capital gains are not taxed in Australia. Share buybacks and other mechanisms may be used to deliver benefits to foreign shareholders. Hence the estimates here concentrate on the readily identifiable gift to foreigners via dividend increases. The other major category we have missed is the foreign direct investors who may receive a benefit in the form of perhaps a more "cashed up" subsidiary. It is not possible to put a figure on that.

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[2] Forecasts and projections of GDP used here are the official estimates as presented in Budget Paper No 1, 2018-19. We also assume constant shares in franked v unfranked dividends and the same shares as measured by company size.