Parliamentary
Budget Office

Request for budget analysis

Changes to franked distributions funded by capital raisings		
Person/party requesting the analysis:	Senator Andrew Bragg	
Date analysis completed:	22 May 2023	
Expiry date of the analysis:	Release of the next economic and fiscal outlook report.	
Status at time of request:	Submitted outside the caretaker period	
	☒ ~~Confidential~~ – Authorised for public release on 31 May 2023	☐ Not confidential

Summary of request:

The request sought the following analyses relating to the 'Tax integrity — franked distributions funded by capital raisings' measure from the 2016-17 Mid-Year Economic and Fiscal Outlook. The measure was costed according to Schedule 5 in the *Treasury Laws Amendment Bill 1 2023* (the Bill) to increase revenue by $10 million per year.

1. How the forecast amount would change if it was assumed corporate Australia would reduce their overall corporate tax paid by

   0.5%

   1%

   5%

   10%

2. The same as Item 1, but only for tax paid in each year that is not paid out in franked dividends.

The request further sought the following pieces of information:

3. The total franking paid out each year to unlisted companies below the Australian Securities and Investment Commission's large company reporting threshold ($50 million)
4. Total franking credits claimed by philanthropic companies with deductible gift recipient status, including a breakdown of how much was from off-market buy-backs, special dividends and ordinary dividends.

The analyses were requested to be backdated to apply to distributions made on or after 15 September 2022. Ongoing projections were requested for Items 1 and 2, while Items 3 and 4 were requested for the most recent year available.

Overview

Responses to each element of the request are included below. Where data relating to these requests is publicly available, the Parliamentary Budget Office (PBO) has included reference to where those figures can be obtained.

The PBO has provided data for some additional historical years relating to questions 3 and 4. Due to the COVID-19 pandemic, figures relating to 2019-20 and 2020-21 may not be a good reflection of standard economic activity. Figures for 2018-19 have been included to provide some of this context. Where the PBO has not been able to address a question in detail, we have included supporting information to the best extent possible.

Question 1

Forecasts relating to company taxation receipts can be found in Table 5.7 of the 2023-24 Budget Paper no. 1 (page 185)[1]. The reductions in company tax revenue at the requested scenario levels is provided in Table 1.

Table 1: Forecast company tax (cash) receipts and various tax reduction scenarios ($b)

	2022-23	2023-24	2024-25	2025-26	2026-27
Company tax receipts	138.4	128.7	119.8	130.2	128.6
0.5% reduction	*-0.7*	*-0.6*	*-0.6*	*-0.7*	*-0.6*
1% reduction	*-1.4*	*-1.3*	*-1.2*	*-1.3*	*-1.3*
5% reduction	*-6.9*	*-6.4*	*-6.0*	*-6.5*	*-6.4*
10% reduction	*-13.8*	*-12.9*	*-12.0*	*-13.0*	*-12.9*

In broad terms, reductions in company tax receipts do not happen in isolation. The fiscal impact of any specific driver will depend on the mechanisms which apply. The various mechanisms set out below may result in increases or decreases elsewhere in the tax system. The key tax reduction mechanisms may include:

- companies relocating offshore (resulting in less activity captured by the Australian tax system)
  - companies servicing only international clients may elect to shift activity from the Australian market to other foreign based companies, or leave altogether.
  - companies servicing Australian clients could move all or part of their operations offshore. However, such an impact would likely be mitigated to some extent by a competitor expanding their activities and increasing their profits, or the entrance of another competitor to the marketplace.
  - analysis of this kind of scenario would require the use of a macroeconomic model, which the PBO does not maintain or have expertise, so we are unable to quantify the net impact on tax.
- a reduction in income or increase in expenses to reduce profit and hence tax
  - companies may increase their capital investment, resulting in increased depreciation or other capital deductions, reducing tax in the short term, but resulting in higher earnings and higher tax in the future.
  - companies may artificially decrease income (decrease price or volume) or increase expenses (e.g. hire more than the optimal staffing level) in order to avoid paying the same level of tax. However, this would be counter to shareholder interests and as such may not be pronounced.
  - In these cases, increased expenses for one business will result in higher revenue for another business or businesses. For example, if a company builds a warehouse, the warehouse building business will increase its revenue, resulting in more tax.
  - analysis of this kind of scenario would also require the use of a macroeconomic model and we are unable to quantify the net impact on tax.

[1] 2023-24 Budget Paper No. 1 - Budget Strategy and Outlook – Page 157

- an increase in non-compliance
  - companies may engage in a higher level of tax non-compliance or avoidance activities including non-payment of liabilities, though such activities may attract heavy penalties. This area of tax compliance is more suited to analysis by the Australian Taxation Office (ATO) than the PBO.

Question 2

We estimate that between 80% and 90% of company tax is eventually distributed to owners as franking credits, although this may take several years to eventuate.

If company tax were reduced for any reason, with percentages shown in Table 1, around 10% to 20% of these amounts would not be paid out as franking credits.

Question 3

The estimated value of franking credits paid out by private companies with a turnover of less than $50 million is outlined in Table 2. The PBO has assumed all relevant companies would be paying tax at the 27.5% rate.

Table 2: Estimated franking credit paid out by companies with annual turnover of less than $50 million ($b)

	2018-19	2019-20
Value of franking credit paid out	11.2	12.1

Question 4

The value of franked dividends claimed by charities is outlined in Table 3. The PBO is not able to further break this down to only show philanthropic companies with deductible gift recipient status, nor separate out the amounts relating to off-market buy-backs, special dividends and ordinary dividends.

Table 3: Franking refunds claimed by charities ($b)[(a)]

	2018-19	2019-20	2020-21
Value of franking refunds claimed	1.49	2.10	1.04

(a) Source: Taxation statistics 2019-20, Charities detailed table 1

Methodology

For questions 1, 2 and 4, data were sourced from the 2023-24 Budget, or historical taxation statistics published by the ATO.

For question 3, the PBO analysed 2018-19 and 2019-20 company tax datasets provided by the ATO.

Data sources

The Australian Taxation Office provided the company tax dataset for the 2018-19 and 2019-20 years.

Australian Government, 2023. *Budget 2023-24, Budget Strategy and Outlook, Budget Paper no. 1.* Commonwealth of Australia.

Australian Taxation Office, 2022. *Taxation statistics 2019-20.* [Online] Accessed 8 May 2023 from [Taxation statistics 2019–20 | Australian Taxation Office (ato.gov.au)]