

Qantas and other big Australian businesses are investing regardless of tax cuts

Written by Jeff Coulton, Senior Lecturer, UNSW

[Research](#) shows that tax cuts lead to increases in corporate investment. But analysis of Australian companies' financial statements, and what American companies have done since the [Trump tax reform](#), show this increased investment could be rather small.

High-profile Australian CEOs have been [campaigning](#) for company tax cuts, claiming it would lead to more corporate investment, jobs and even wage rises.

But it is unlikely that a lower tax rate will be a key driver of investment. Especially as companies like Qantas have [already announced](#) billions in investments.

Read more: [Why Australia doesn't need to match the Trump tax cuts](#)

The idea behind tax cuts driving investment is that they create more “[free cash flow](#)”. This is the amount of cash a business generates from its day to day operations minus what it spends on capital expenditure (property, equipment and maintenance for example).

[Studies](#) show more free cash flow does, on average, lead to increased investment. But the extra cash is also used to pay down debt, pay dividends and increase working capital (cash used for day to day expenses).

A look at the books

Qantas CEO Alan Joyce has been [one of the most vocal](#) proponents of corporate tax cuts, claiming it could lead to new routes and the purchase of new aircraft.

This is plausible, but a 5% tax cut is not likely to lead to huge increases in profitability or cash

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flows for Qantas. At least in the short term.

Qantas [currently has](#) A\$951 million of tax losses due to a couple of lean years [before 2014](#). These can be used to offset any future taxable income.

Qantas will not pay tax until its profits in the years after 2014 exceed the tax losses recorded before 2014. Only once these tax losses have been used up will a lower tax rate lead to an increase in cash flow.

But even if Qantas didn't have tax losses, the impact of the tax cut would be marginal. Analysts are [forecasting](#) earnings growth of 1.2% for Qantas in the 2018 financial year.

Given 1.2% profit growth, a 5% reduction in Qantas' effective tax rate would mean an additional A\$60 million in after tax profit in 2018.

This additional A\$60 million for Qantas is relatively small when you compare it to the [A\\$3 billion](#) in capital investment already announced for 2018 and 2019.

This investment was planned, and it's irrespective of any tax cuts. Qantas generated over A\$2.7 billion in cash in 2017, so the A\$3 billion capital investment was already plausible without a tax cut.

A similar analysis on Wesfarmers' [2017 results](#) shows a 2017 pre-tax profit of A\$4.1 billion. A 5% reduction in the tax rate would correspond with an approximate saving of just A\$206 million in 2017, compared to A\$ 1.6 billion [in capital investment](#).

For a smaller company like [MYOB](#), with a pre-tax profit of A\$73.7 million in 2016, the impact is

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even smaller. A 5% tax saving would result in an increase in after-tax profits of just under A\$4 million.

Read more: [Business investment is weak, but an unfunded company tax cut won't fix it](#)

So, it is plausible that tax cuts could lead to increased investment, more jobs or higher wages. Changes in tax rates can affect both investment decisions and shorter-term operational decisions.

But beyond the circumstances of individual companies, there are other factors that in how tax cuts factor in to company investment. This includes [how competitive](#) an industry is, and whether it is capital or labour intensive.

When corporate taxes are changed, firms [will also](#) try to shift their spending and profits, where possible, in order to claim the most profits in periods of lower tax.

One way to do this is to pay bonuses. In the United States, we have seen [over 150](#) public companies announce bonuses following the recent tax reform. These bonuses are not a permanent salary increase. They are being paid this year, reducing the firm's current taxable income, before tax rates change.

While the claims of increased corporate investment and jobs are supported by the research, and even the recent US experience, we should be wary about how large the benefits are.

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