The international competitiveness of Australia's corporate taxation system is becoming an increasingly important factor in the health of the Australian economy. In a global economy where investment flows are free to cross national borders to seek the best returns, the structure of our corporate taxation system is a key determinant of our ability to attract and retain capital. Unfortunately, clarity of debate regarding the competitiveness of our corporate taxation system has been difficult. Company taxation is not well understood in the community and, since the last round of reforms, has been avoided by the government as too politically sensitive to allow discussion or public analysis. There remains very little meaningful debate on further corporate tax reform. Understanding of this issue is not helped by limiting examinations of Australia's corporate tax competitiveness to the statutory rate. The statutory or headline rate is an important indicator of how companies are being taxed and it is often the first indicator that companies look at when making choices about where to invest. However, it is only part of the picture. The other side is the treatment of business income, which varies significantly from country to country. The combined result provides the overall taxation burden that companies face in one country compared to another. Ultimately, it is the total taxation burden faced by Australian companies that will make the significant difference to Australia's prospects for the future.

Corporate Taxation

AN INTERNATIONAL COMPARISON
2006 UPDATE

Business Council of Australia

A Survey by the
Business Council of Australia

with assistance from

KPMG

DECEMBER 2006

Contents

1. Executive Summary

In October 2005 the Business Council of Australia published the first comprehensive examination of Australia's corporate tax burden. Now, 12 months on, we re-examine Australia's position relative to our key competitors to assess how things have changed.

The news is not good.

Australia's corporate tax burden has risen to 5.7 per cent of GDP, more than double that of the United States and close to double that of the United Kingdom. It is also one-third higher than key regional trading partners Japan, Singapore, China and Malaysia. Australia's corporate tax burden remains the highest against every relevant global comparison, and its relative position is worsening.

In the 12 months since the publication of the BCA's report *Corporate Taxation: An International Comparison*, we have seen long-awaited and significant reforms to both the personal income tax and superannuation tax systems. However, there have been few significant business tax reforms in recent years. Meanwhile, other countries are aggressively pursuing more competitive corporate tax systems. As this report shows, there have been significant movements among some of Australia's key competitors over the last year.

Shortly after the release of the BCA's original report, the federal government commissioned its *International Comparison of Australia's Taxes*. Released in April 2006, the report confirmed the BCA's contention that, while our headline corporate tax rate was broadly comparable, Australia's corporate tax burden was the highest among all relevant comparator countries.

Corporate tax burden: the burden of taxation borne by corporations. Indicators of the level of the corporate tax burden commonly include corporate tax as a percentage of total taxation revenue or as a percentage of GDP. For the purposes of this report we are comparing tax burdens as a percentage of GDP. Australian taxes included in the OECD's measure of Australia's tax burden are corporate income tax, taxes on superannuation funds, and petroleum resource rent tax.

Corporate tax headline rate/corporate tax rate: the statutory rate of taxation applied to corporate profits. This rate does not include any offsets, deductions or concessions that may reduce the effective rate of corporate tax. Australia's statutory or headline rate is currently 30 per cent.

With Australia's corporate tax burden continuing to deteriorate relative to its peers, now is the time to refocus on corporate taxation, and undertake the measures needed to help position Australia for future growth. We must develop a vision and a strategy for corporate tax reform if Australia is to take full advantage of global opportunities.

As an organisation representing the CEOs of 100 of Australia's leading companies, which account for a substantial share of Australia's domestic and overseas business activity, the BCA has a significant interest in supporting public policy reform that positions Australia as a strong and vibrant economy and society.

As highlighted in the 2005 survey, how companies are taxed impacts on a wide range of business decisions, from employment and investment to location. Consequently our corporate taxation system has the potential to have a significant impact on the long-term prosperity of Australia.

The international competitiveness of Australia's corporate taxation system is becoming an increasingly important factor in the health of the Australian economy. In a global economy where investment flows are free to cross national borders to seek the best returns, the structure of our corporate taxation system is a key determinant of our ability to attract and retain capital.

Unfortunately, clarity of debate regarding the competitiveness of our corporate taxation system has been difficult. Company taxation is not well understood in the community and, since the last round of reforms, has been avoided by the government as too politically sensitive to allow discussion or public analysis. There remains very little meaningful debate on further corporate tax reform.

Understanding of this issue is not helped by limiting examinations of Australia's corporate tax competitiveness to the statutory rate. The statutory or headline rate is an important indicator of how companies are being taxed and it is often the first indicator that companies look at when making choices about where to invest. However, it is only part of the picture. The other side is the treatment of business income, which varies significantly from country to country. The combined result provides the overall taxation burden that companies face in one country compared to another. Ultimately, it is the total taxation burden faced by Australian companies that will make the significant difference to Australia's prospects for the future.

The 2005 report also dispelled a number of myths concerning Australia's internationally high corporate tax burden. Australia's high corporate tax burden cannot be sufficiently explained by strong profit growth, the lack of loss offsets, the dividend imputation system or differences in international revenue statistics. Primarily, Australia's high tax burden is caused by a combination of a headline corporate tax rate that now sits above the OECD average, and a tax system that treats key aspects of business income differently from many key competitor countries.

Urgent policy action is needed to remedy this situation. As this update highlights, other competitor countries are constantly adjusting their corporate taxation regimes in order to remain competitive and support investment in their economies. As the competition for internationally mobile capital intensifies, Australia needs to ensure that its corporate taxation system is well placed to attract and retain investment flows.

1.1 | WHY THE CORPORATE TAX BURDEN IS IMPORTANT

Statutory corporate tax rates typically receive the greatest attention when comparing the competitiveness of different tax systems across countries because they are easily identifiable and provide a simple comparison.

However, in a competitive global environment where many countries are offering a variety of tax concessions to attract foreign direct investment, what ultimately matters is the total burden of taxation.

The inaugural survey highlighted the compelling body of empirical research showing that high corporate tax burdens imposed by governments deter foreign investment inflows.[1] Globalisation is increasing the mobility of capital and Australia must remain competitive to attract foreign inflows of capital, particularly with the growing global significance and geographic proximity of countries in our region such as China, India, Hong Kong and Singapore.

There are indications that Australia's competitiveness as an investment destination for global capital has been diminishing. In 1990, Australia held 4.1 per cent of the world's stock of inward foreign direct investment, but by 2000 this share had decreased to 1.92 per cent. Despite the reforms undertaken by the Ralph Review of Business Taxation to improve the international competitiveness of Australia's corporate taxation system, in 2005 our share of the stock of global inward foreign direct investment still stood at only 2.08 per cent.

Our ability to attract and retain investment should be a primary focus of policy makers in Australia. Investment is a driver of productivity, employment and growth in the economy. A corporate taxation system that acts as an inhibitor to the attraction and retention of investment is a brake on economic prosperity and wealth creation. This is supported by research that shows a negative relationship between the economic growth of countries and their corporate tax rates.[2]

1.2 | THE DIFFERENCE A YEAR MAKES

The 2005 report highlighted that Australia's corporate tax burden was the highest against every relevant global comparison. In 2006 our relative position has deteriorated.

As with the original survey, this report compares the headline corporate tax rate and corporate tax burden in Australia with the same measures in a range of comparable economies selected on the basis of their likely competitive impact on Australia now and in the future. These include the OECD, EU, selected Asia–Pacific economies, and Australia's major trading and investment partners.

Urgent policy action is needed to reduce Australia's corporate tax burden

A clearly identifiable pattern emerges when Australia is compared to these groups of countries. Although Australia's corporate tax reforms of 1999 took us to a competitive position, that benefit was short-lived. In the succeeding years, other countries have aggressively positioned themselves to take advantage of a highly competitive international economy. As a small, open economy, relatively distant from significant global markets, Australia needs to achieve a better-than-average policy environment to ensure its attractiveness as a business destination.

Australia's corporate tax rate of 30 per cent now sits above the OECD average of 28.4 per cent, and well above the EU average of 24.8 per cent. The average tax rate of the Asia–Pacific now sits at 30.1 per cent.

Continuing the 2005 trend, seven countries in the OECD grouping and six in the EU grouping have lowered their corporate tax rates. None have increased them, reducing the average tax rates of these two groupings still further. Importantly, when the business tax reforms came into effect in 2000, Australia's statutory corporate tax rate was below the OECD and EU averages; in 2006 it is above them.

An even more worrying picture emerges when looking at Australia's corporate tax burden. Australia's corporate tax burden of 5.7 per cent of GDP is considerably higher than the averages of the OECD (3.4 per cent), the EU (3 per cent) and the Asia–Pacific (3.5 per cent).

Disregarding Norway and Luxembourg due to features particular to those economies, Australia has the highest corporate tax burden across every relevant global comparison. This outcome is of significant concern as the corporate tax burden is considered a more complete measure of economic competitiveness.

If this issue is not addressed, there is a risk Australia will become increasingly uncompetitive as an investment destination, and decisions such as where to locate existing or new business operations, employment, and capacity for innovation and risk will be affected. The result of this is a taxation system that creates a barrier to, rather than assists, business and Australia's economy to operate with flexibility and rise to the challenge of succeeding in an increasingly competitive world.

The potential ramifications of these competitive barriers go further than the business community. The Australian Government relies heavily on corporate taxation revenue. Corporate taxation is the second-largest revenue stream and the fastest growing (company tax receipts have risen from $27.1 billion in 2001–02 to almost $49 billion in 2005–06) for the federal government. A corporate tax system that constrains rather than promotes the future prosperity of business and the economy will have adverse consequences for revenue. Without a strong corporate taxation revenue stream, future Australians will not be able to afford the same level of services that they currently enjoy. Perhaps even more concerning for Australia's future prosperity is that an unhealthy business sector could limit employment and investment opportunities, and result in Australia not being able to afford other much-needed reform measures.

1.3 | RECENT CHANGES IN AUSTRALIAN CORPORATE TAXATION

There is a perception that significant reform has only recently been undertaken. However, these reforms have not addressed the issue of the total tax burden on Australian business. In 1999 the government accepted the recommendations of the Ralph Review of Business Taxation to reduce Australian corporate tax rates from 36 per cent to 30 per cent.

This change was overdue given the extent of movement already occurring internationally, but the changes in corporate tax rates were funded in large part by the replacement of accelerated depreciation concessions with a uniform capital allowances regime based upon the effective life of assets. The loss of accelerated depreciation as a trade-off for a reduced corporate tax rate was supported by the Australian business community as it was felt that it was essential to lower the statutory rate in order to maintain Australia's competitiveness.

However, the reduced corporate tax rate was not low by international standards at that time, and seven years later the benchmark set by our competitors has moved even further.

In addition, while the revenue impact was intended to be neutral, the actual results have been quite different. The impact of the changes in corporate taxation, including concessions foregone such as accelerated depreciation, have been far more costly for business and have produced a far greater gain to government revenue than anticipated. Despite the reforms, the taxation burden facing companies has increased steadily since the Ralph Review.

Under the Ralph reforms, Australia's statutory corporate rate dropped from 36 per cent to 34 per cent in the 2000–01 financial year, then to 30 per cent in 2001–02. Yet after dropping from an all-time high of 6.3 per cent in 2000 to 4.5 per cent in 2001 after the initial rate cut, Australia's corporate tax burden has climbed steadily, reaching 5.7 per cent in 2004.

allow non-residents to dispose of other Australian assets without the imposition of Australian tax. This is expected to have a positive impact on foreign investment in Australia.

However, these changes will not have any significant impact on Australia's corporate tax burden.

Another increase in the tax burden of the magnitude we have seen in the past 12 months will see Australia's tax burden back above 6 per cent – to pre-Ralph Review levels.

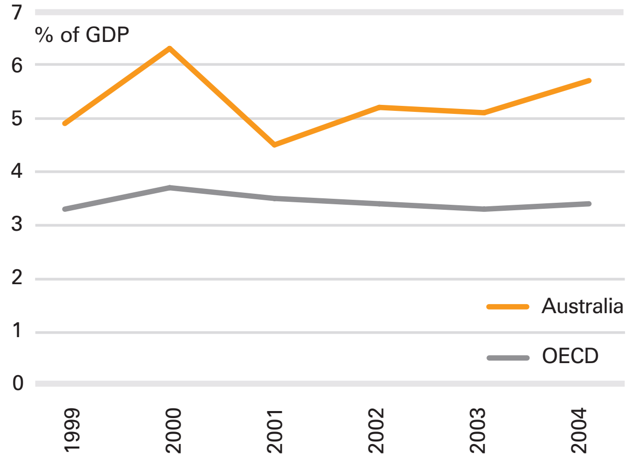
As Figure 1 shows, over the same period the OECD average tax burden remained almost steady.

The last 12 months have seen only minor adjustments to Australia's business tax regime.

The 2006 Budget announced an increase in the diminishing value rate under the uniform capital allowances regime from 150 per cent to 200 per cent for eligible assets acquired on or after 10 May 2006, which will mean a minor acceleration in tax depreciation deductions, reducing the cost of holding assets in net present value terms.

Legislation was introduced to give effect to a change announced in the 2005 Budget that will change the way capital gains tax (CGT) applies to the assets of non-residents. Under current laws, non-residents are subject to Australian capital gains tax on all their Australian investments. However, the changes, which will bring Australia into line with standard OECD practice, mean that Australian branches of non-resident companies will only be taxed on real property assets and business assets. It will be a much-needed change for non-residents investing in Australia and, once enacted, will

FIGURE 1
MOVEMENTS IN TAX BURDENS: OECD AND AUSTRALIA
CORPORATE TAX BURDEN AS A PERCENTAGE OF GDP



Source: OECD Revenue Statistics 1965–2004.

2. Global Developments in Corporate Taxes

2.1 | TRENDS IN CORPORATE TAX

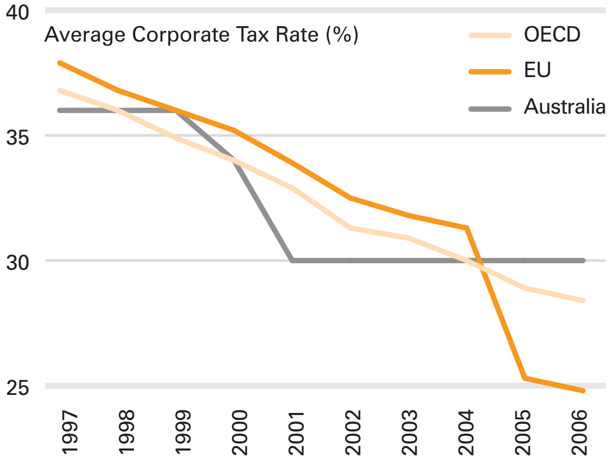
The current trend in corporate tax rates around the world has been towards reductions (see Figure 2). The trend towards lower corporate tax rates has been most pronounced in Europe, with several countries seeking to emulate the highly successful example set by Ireland in reducing its corporate tax rates as a key element of their economic policy. This trend towards low tax rates as a means of attracting and stimulating investment has been followed by most of the eastern European economies. Responding to this challenge, many western European countries have also cut their rates in the past 12 months, including France, the Netherlands, Greece and Denmark.

The average statutory corporate tax rate in the EU continues to fall. Eighteen of the 25 EU member states have statutory corporate tax rates of less than 30 per cent. Some, like Germany, have recently announced plans to reduce their corporate rate to less than 30 per cent. In addition, some countries, like Belgium, are considering alternative tax system changes to boost their competitiveness as an investment destination.

In the Asia–Pacific region, India has moved to reduce its corporate tax rate. Although the average Asia–Pacific headline rate of 30.1 per cent remains the closest to Australia's of all the groupings examined, it should be remembered that many of the selected economies in the region also offer substantial tax concessions that are designed to attract foreign direct investment. These measures, which can significantly reduce their tax burdens relative to Australia, include free-trade zones, concessions for 'pioneer industries' and sector-specific concessions for strategic industries. These are discussed in more detail at the end of Section 3.

Many of Australia's competitors are actively reforming their corporate tax regimes

FIGURE 2
OECD, EU AND AUSTRALIA – STATUTORY CORPORATE TAX RATES



Source: KPMG Corporate Tax Survey 2006.

2.2 | RECENT DEVELOPMENTS BY SOME KEY COMPETITORS

Australia's competitors understand the importance of an efficient and effective corporate taxation system. Governments are in competition with each other for companies' investment, employment, innovation and creative ideas. While Australia has made a number of minor changes to the corporate tax system this year and has undertaken some overdue but important steps in the area of international taxation over the last four years,[3] these changes are not substantial when viewed against the movements in corporate taxation globally. Importantly, Australia's recent changes do not significantly address the rate or burden companies face. Following are some of the most recent international developments.

BELGIUM

Tax laws have been amended to provide Belgian companies and Belgian branches of foreign companies a tax deduction based on their equity as of January 2006. The new rules are intended to ensure equal treatment of loan and equity capital.

Under the so-called 'notional interest deduction' all companies subject to Belgian corporate tax will be able to deduct from their taxable income an amount equal to the interest they would have paid on their capital in the case of long-term debt financing.

The objectives of the notional interest deduction are to provide:

- a general reduction of the effective corporate tax rate for all companies, and a higher after-tax return on investment;
- encouragement for capital-intensive investments in Belgium, and an incentive for multinationals to examine the possibility of allocating such activities as intra-group financing, central procurement and factoring, to a Belgian group entity; and
- continuing opportunities for tax-efficient, equity-funded, inter-company financing from Belgian companies, such as the Belgian Coordination Centres (BCC).

DENMARK

There have been significant changes to Danish corporate tax rules that take effect for income years beginning on or after 15 December 2004. Mandatory national tax consolidation was introduced and the corporate tax rate will be reduced from 30 per cent to 28 per cent.

GREECE

The rate of corporate income tax for the 2006 financial year will be reduced from 32 per cent to 29 per cent. This rate applies to all A.E. companies (corporations), E.P.E. entities (limited liability companies), domestic unlisted A.E. companies, banks and credit institutions operating as cooperatives, and branches of foreign entities. The rate will be reduced to 25 per cent for 2007 and onwards.

GERMANY

In November 2006 the German Government announced plans to cut the average corporate tax rate from 38.7 per cent to 29 per cent from 1 January 2008. The cut will be partially offset by base-broadening measures. The government cited concerns about attracting investment in the global environment as a key influence. As seen later in this report, Germany already has the lowest corporate tax burden in the EU.

MALAYSIA

Malaysia's Budget in September 2006 included a reduction in corporate tax from 28 per cent to 27 per cent in 2007, to be followed by a further reduction to 26 per cent in 2008.

NETHERLANDS

Since 2005 the Netherlands has been planning to make the country more attractive to foreign investors by reducing rates and broadening the tax base. The top corporate income tax rate will be reduced from 31.5 per cent to 26.9 per cent or even lower over the next few years. For fiscal 2006 the top corporate income tax rate was reduced to 29.6 per cent. In addition, the capital duty on share issues has been abolished. The tax base will be broadened by restricting the depreciation of real estate and limiting the period during which loss carry-forwards and carry-backs can be used.

NEW ZEALAND

Corporate tax cuts will be announced in the 2007 Budget to take effect in April 2008 and they are expected to be accompanied by changes to personal income tax thresholds. The business tax review is likely to produce a mix of a lower corporate tax rate and tax credits, particularly helping those businesses focused on lifting their performance, expanding and tackling overseas markets. Options include targeted credits to encourage investment in research and development, exports and skills development.

SINGAPORE

In November Singapore announced that it intends to increase its rate of GST from 5 per cent to 7 per cent, in part to pay for proposed cuts to income taxes. Singapore proposes to reduce its corporate income tax from the current rate of 20 per cent in order to better compete with Hong Kong and Eastern Europe.

TURKEY

Effective January 2006 the corporate income tax rate was reduced from 30 per cent to 20 per cent. The motive behind the corporate tax reduction is to increase Turkey's competitiveness with current and future EU member states that attract foreign direct investment, as well as to improve the investment environment in Turkey and widen the corporate tax base.

3. Australia's Corporate Taxation Compared

3.1 | ECONOMIES SELECTED

The economies chosen for comparison in this survey have been selected on the basis that they are either current or emerging competitors for Australia in what is becoming an increasingly competitive global environment for investment and the location of high-value-added companies. The economies selected include:

- OECD member countries, representing the industrialised economies in the world.
- EU member states, comprising developed and transitional economies, some of which are also OECD member states. These economies were selected for comparison because of the significance of the EU in the global economy and the broad economic similarities of a number of members with Australia as a developed economy. The EU member states are traditionally regarded internationally as being higher taxing than other developed economies in North America and north-east Asia. However, the recent movement of corporate tax rates in a number of countries, particularly from eastern Europe, has resulted in a steady trend to reduce the corporate tax rate.
- Selected Asia–Pacific and North American economies, including the United States, Canada, several in east Asia, and India, which were chosen on the basis of their importance and growing importance to Australia in trade relationships within the region and as competitors for the attraction of global foreign direct investment.
- Major trading partners, based upon the top 10 countries that constitute two-thirds of total bilateral merchandise trade. These countries were selected for their economic importance to Australia and capacity to compete with Australia.
- Foreign direct investment sources. The top 10 countries in terms of foreign direct investment to Australia have been selected for comparison.

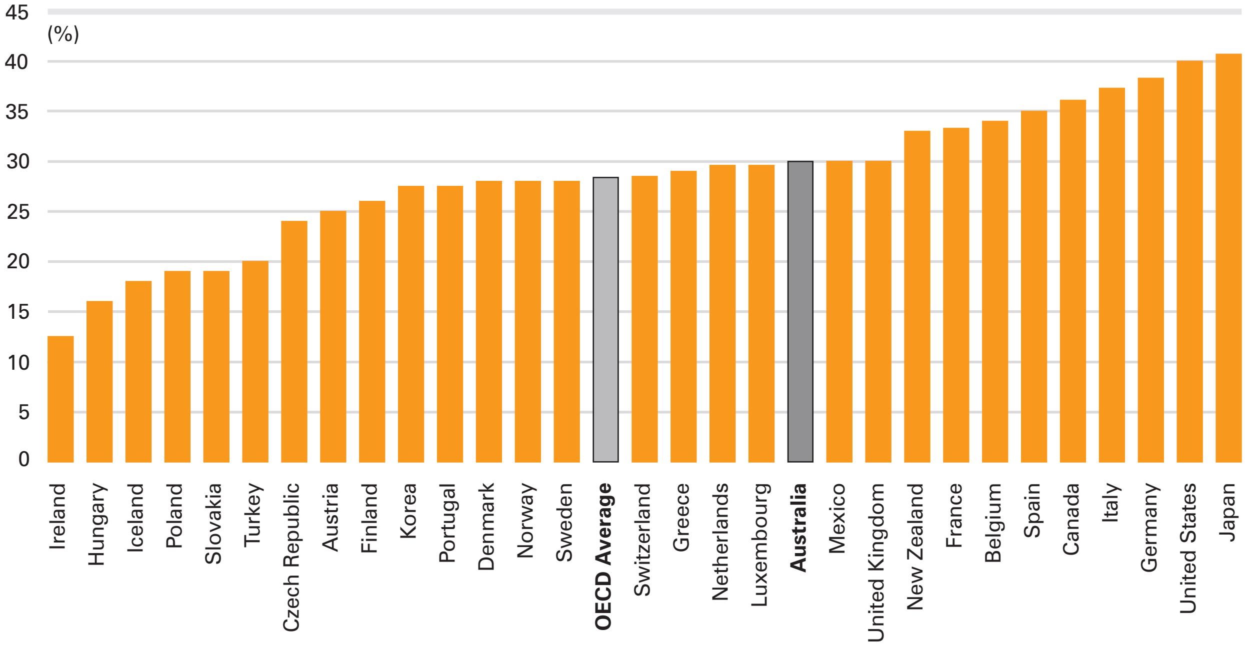
OECD

Australia's headline corporate tax rate of 30 per cent is broadly comparable with the OECD average of 28.4 per cent. However, using the more complete measure of the corporate tax burden, Australia is the third highest in the industrialised world (Figure 4). Australia's corporate tax as a percentage of GDP is 5.7 per cent, significantly higher than the OECD average of 3.4 per cent.

While Australia's headline corporate tax rate compares with the OECD average (Figure 3), it should be noted that most of the top six countries with the highest corporate tax rates (five percentage points or more above Australia's) have relatively low corporate tax burdens. In fact, Germany (with the third-highest corporate tax rate) and the United States (with the second-highest corporate tax rate) have corporate tax burdens less than half that of Australia.

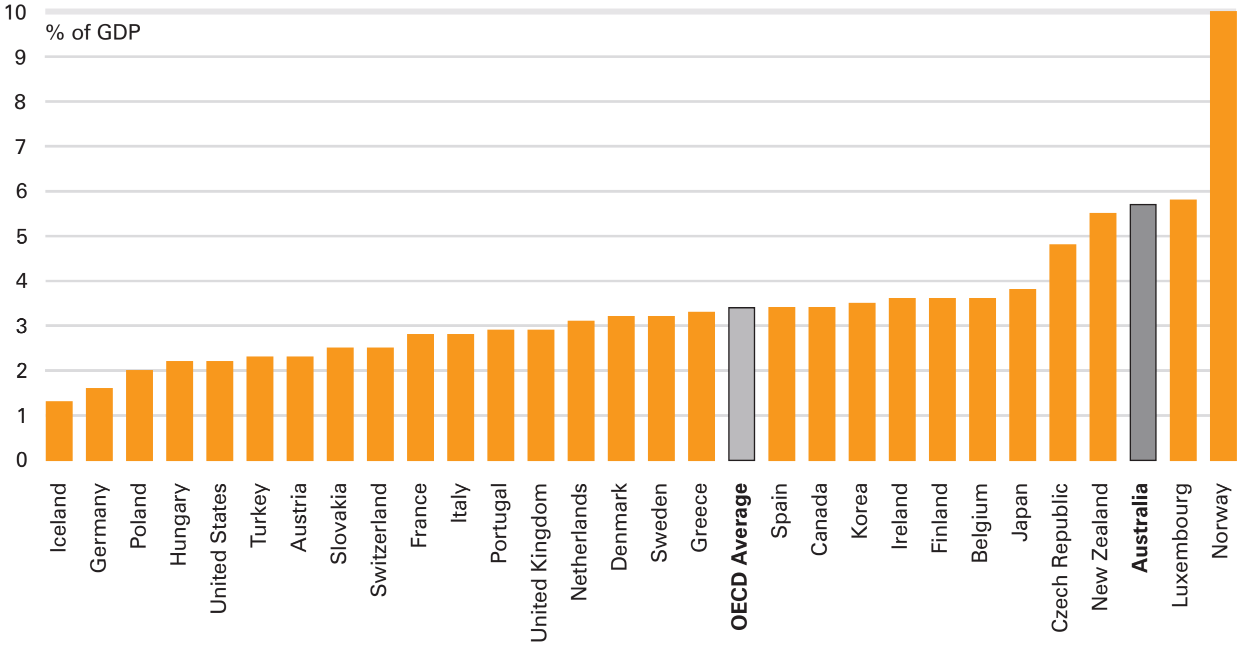
The only two OECD countries with a higher corporate tax burden than Australia (Norway and Luxembourg) have significant and unique factors influencing their corporate tax burden (as discussed in the Appendix). This is evidenced by the fact that their corporate tax burdens are markedly higher than the next closest country, in this case Australia. If these unique factors were isolated for these two countries Australia would have the highest corporate tax burden in the industrialised world.

FIGURE 3
OECD CORPORATE TAX HEADLINE RATES



Note: Canada, Germany, Japan, Switzerland and United States headline rates combine national and average sub-national corporate tax rates.
Source: KPMG Corporate Tax Survey 2006.

FIGURE 4
OECD CORPORATE TAX BURDENS



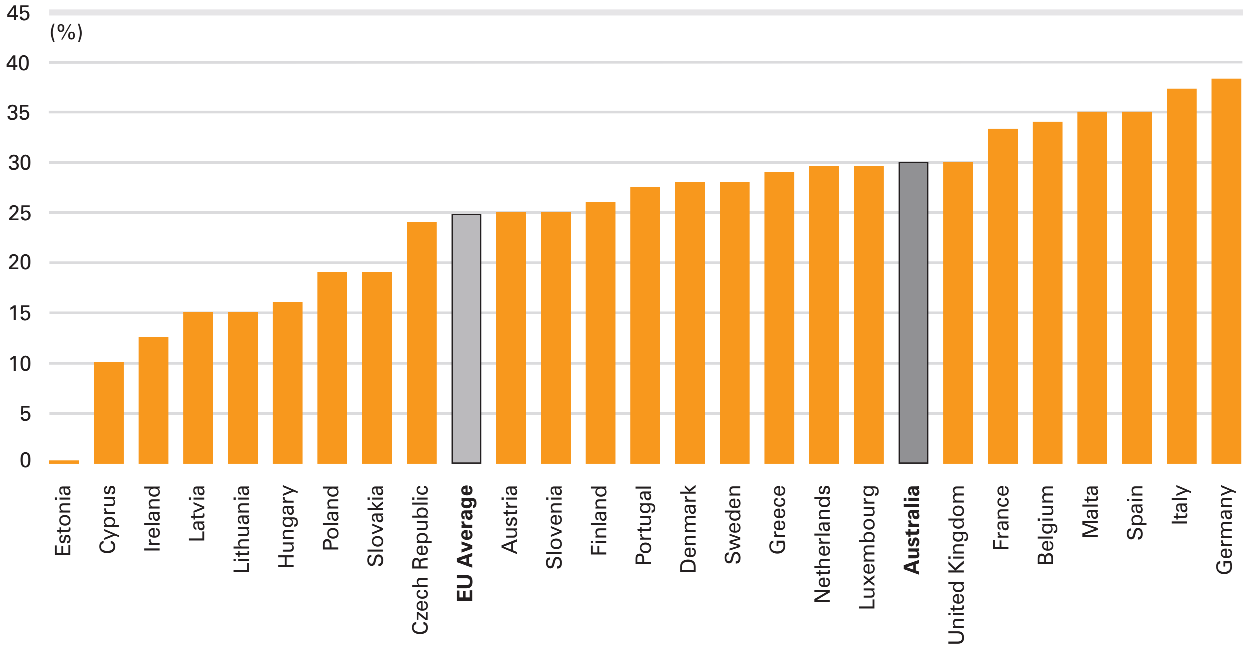
Note: Average does not include Mexico, as disaggregated data for corporate and individual income tax revenue is not available.
Source: OECD Revenue Statistics 1965–2004.

EUROPEAN UNION

The general trend in Europe over the last few years has been to lower the headline corporate tax rate. Australia's headline corporate tax rate of 30 per cent is substantially higher than the EU average headline corporate tax rate of 24.8 per cent (Figure 5). The reduction in corporate tax rates in the EU is expected to continue as older EU member states strive to stay competitive with newer member states that have adopted low corporate tax rates.

Lower corporate tax rates do not automatically mean low corporate tax revenues. Ireland with the second-lowest corporate tax rate in the EU of 12.5 per cent (disregarding Estonia) has a corporate tax burden above the EU average. The United Kingdom, with a corporate tax rate equal to Australia's at 30 per cent, has a tax burden below the EU average. Germany, with the highest corporate tax rate in the EU, has the lowest corporate tax burden. Despite this, Germany has recently announced plans to reduce its headline corporate rate by almost 10 percentage points.

FIGURE 5
EU CORPORATE TAX HEADLINE RATES

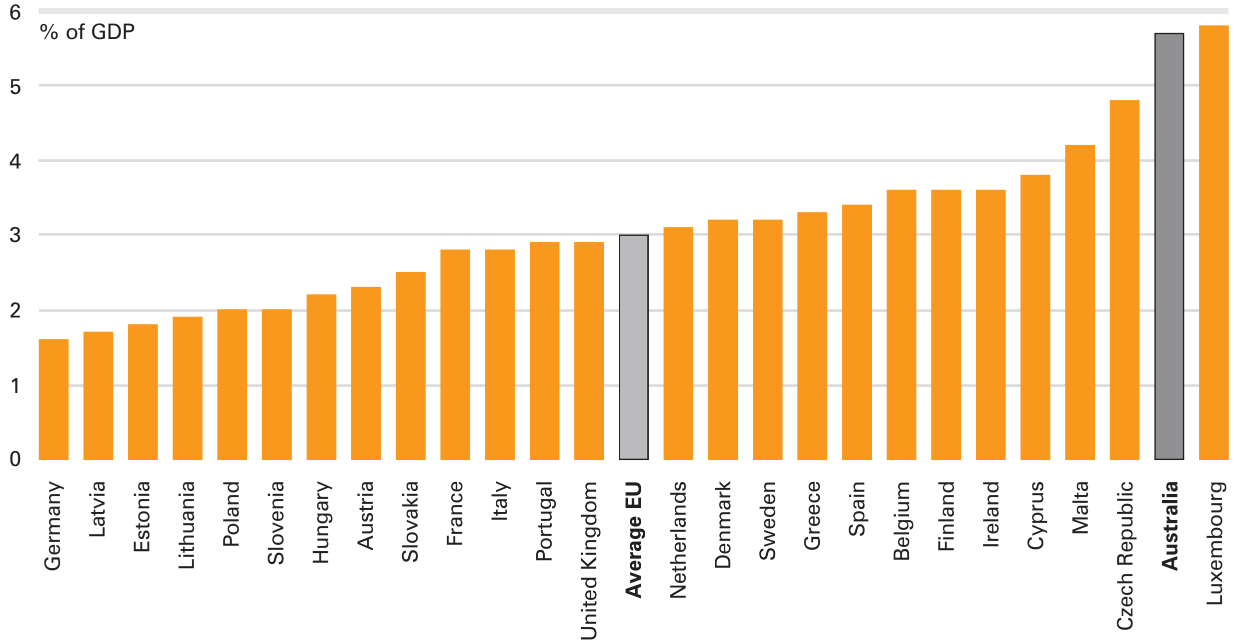


Note: Estonia does not tax corporate retained profits but rather imposes tax on corporate distributions. Germany includes national and average sub-national corporate tax.

Source: KPMG Corporate Tax Survey 2006.

Comparison of Australia's corporate tax burden with the EU economies reveals that only Luxembourg has a higher corporate tax burden (Figure 6). At 5.7 per cent of GDP, the Australian corporate tax burden is significantly higher than the EU average of 3 per cent of GDP. As noted earlier, Luxembourg is not a good comparator for Australia (this is explained in the Appendix).

FIGURE 6
EU CORPORATE TAX BURDENS



Source: *Structures of the Taxation systems in the European Union*, European Communities (2006); OECD Revenue Statistics 1965–2004.

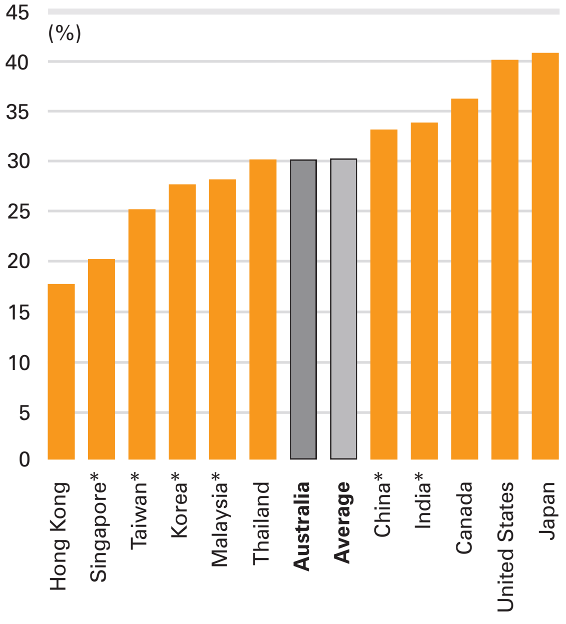
SELECTED ASIA–PACIFIC ECONOMIES

A comparison of Australia's corporate tax rate to key Asia–Pacific economies reveals that Australia's corporate tax rate is in line with the average of 30.1 per cent and at the median in ranking (Figure 7). However, Australia has the highest corporate tax burden of all the selected countries. Australia's corporate tax burden is 5.7 per cent of GDP, significantly higher than the average of the selected Asia–Pacific countries of 3.5 per cent of GDP (Figure 8).

Further, there is a significant difference (1.6 per cent of GDP) between Australia's corporate tax burden and the next highest of the selected economies.

Similar to the previous comparisons, the countries with the highest tax rates (Japan and United States) have comparatively low corporate tax burdens. Also evidenced in the comparison with the selected Asia–Pacific economies is the previously mentioned proposition that a low corporate tax rate does not signify low corporate tax revenues or low corporate tax burden. Singapore with the second-lowest corporate tax rate has one of the highest corporate tax burdens of the comparison countries, higher than the average for the selected Asia–Pacific economies.

FIGURE 7
ASIA–PACIFIC CORPORATE TAX HEADLINE RATES

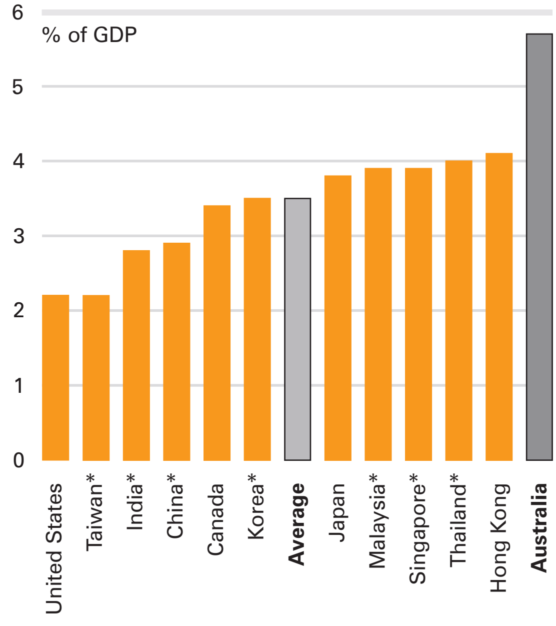


Note: Canada, Japan and US headline rates combine national and average sub-national corporate tax rates.

* These economies offer reduced tax rates or concessions as part of their tax regimes.

Source: KPMG Corporate Tax Survey 2006.

FIGURE 8
ASIA–PACIFIC CORPORATE TAX BURDENS



Note: China also has a 'business tax' which is an indirect tax rather than a tax on corporate profits and therefore is not included in this calculation.

* These economies offer reduced tax rates or concessions as part of their tax regimes.

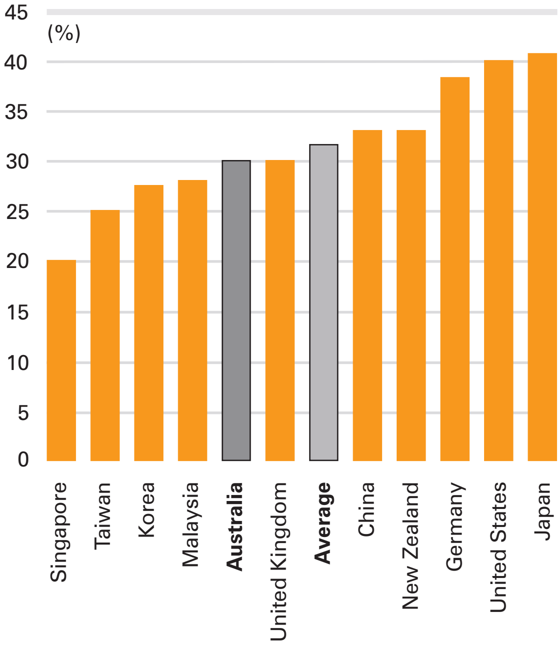
Source: OECD Revenue Statistics 1965–2004 and information available from non-OECD revenue authorities.

MAJOR TRADING PARTNERS

A similar pattern to the comparison with selected Asia–Pacific economies emerges when Australia is compared to its major trading partners. In this comparison, Australia's corporate tax rate is slightly lower than the average of 31.6 per cent (Figure 9). However, Australia has the highest corporate tax burden when compared with its major trading partner economies. The average among the trading partner economies is 3.2 per cent of GDP, considerably lower than Australia's corporate tax burden of 5.7 per cent of GDP (Figure 10).

The same observations can be made in relation to the countries with the highest corporate tax rates having low corporate tax burdens. Two countries with high corporate tax rates (the United States and Germany) have corporate tax burdens well below the average.

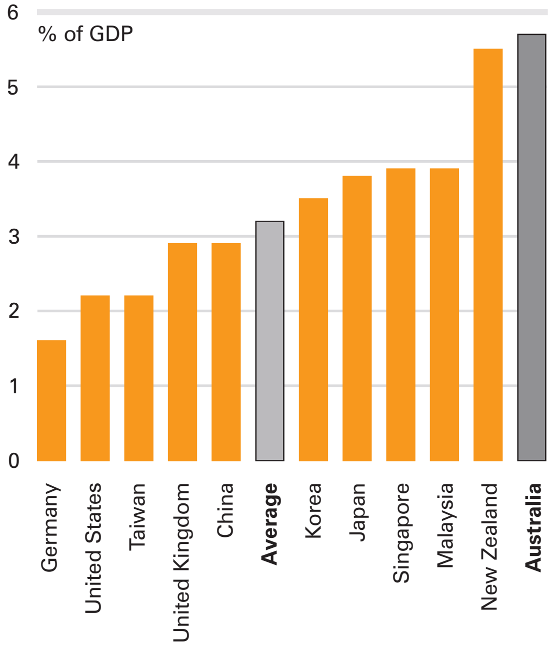
FIGURE 9
MAJOR BILATERAL TRADING PARTNERS
CORPORATE TAX HEADLINE RATES



Note: Germany, Japan and United States headline rates combine national and average sub-national corporate tax rates.

Source: KPMG Corporate Tax Survey 2006.

FIGURE 10
MAJOR BILATERAL TRADING PARTNERS
CORPORATE TAX BURDENS



Note: China also has a 'business tax', which is an indirect tax rather than a tax on corporate profits and therefore is not included in this calculation.

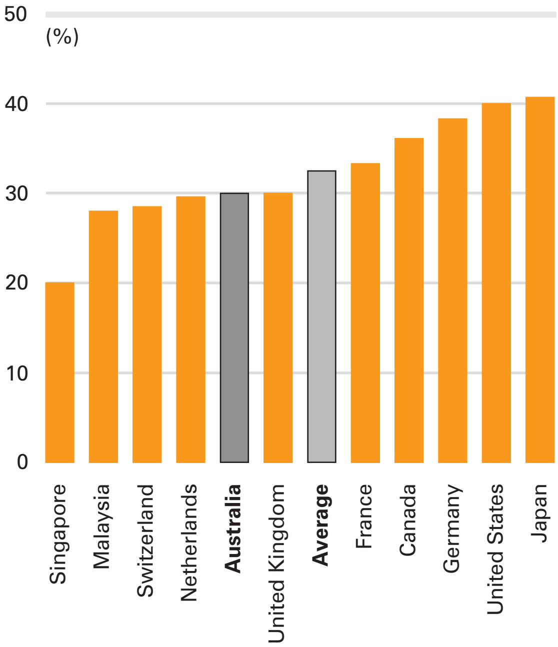
Source: OECD Revenue Statistics 1965–2004 and information available from non-OECD revenue authorities.

FOREIGN DIRECT INVESTMENT SOURCES

Australia's headline corporate tax rate appears competitive when compared with headline corporate tax rates in the economies that are the major source of foreign direct investment for Australia (Figure 11).

On the more complete measure of corporate tax as a percentage of GDP, Australia's corporate tax burden is significantly higher than the economies that are the source of most of its foreign direct investment (Figure 12).

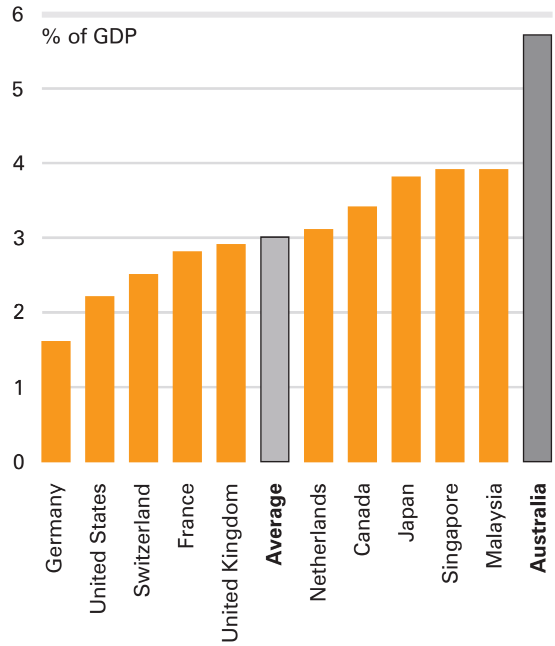
FIGURE 11
SOURCES OF FOREIGN DIRECT INVESTMENT
CORPORATE TAX HEADLINE RATES



Note: Canada, Germany, Japan, Switzerland and United States headline rates combine national and average sub-national corporate tax rates.

Source: KPMG Corporate Tax Survey 2006.

FIGURE 12
SOURCES OF FOREIGN DIRECT INVESTMENT
CORPORATE TAX BURDENS



Source: OECD Revenue Statistics 1965–2004 and information available from non-OECD revenue authorities.

3.2 | AUSTRALIA COMPARED

A clear pattern emerges when Australia is compared to both key regional groupings and individual competitor countries. In almost all comparisons, Australia's corporate tax rate of 30 per cent compares favourably with the averages for the selected groups. Only in the comparison to the EU countries is Australia's corporate tax rate substantially higher than the average of 24.8 per cent.

However, Australia's corporate tax burden is considerably higher than the averages of the selected groups. Disregarding Norway and Luxembourg due to features particular to those economies, **Australia has the highest corporate tax burden across every relevant global comparison**.

This survey indicates that Australia's corporate tax burden is becoming increasingly out of step with its competitors. As discussed earlier, a high corporate tax burden is potentially detrimental to Australia's future growth and prosperity and as such further reform to reduce the corporate tax burden is critical.

3.3 | COUNTRY COMPARISONS

A number of countries have higher statutory corporate tax rates than Australia, but many have lower corporate tax burdens. The reason for this difference is often that these countries have arrangements that provide significant relief from the general corporate tax rate. These forms of relief include measures such as special tax rates for specific sectors of the economy, or incentives provided in the form of accelerated depreciation and higher tax credits for certain foreign sourced income.

Common among industries that will receive special treatment are the small business sector, the shipping industry and financial institutions. Research and development incentives are also forms of tax expenditure that result in lower corporate tax burdens.

Countries that have both low statutory corporate tax rates and low corporate tax burdens have recently reformed their corporate tax systems, either as an initiative to encourage both domestic companies to develop or to attract foreign direct investment. This approach often combines low statutory rates with various other tax incentives such as accelerated depreciation or special economic zones. A number of countries have also moved to lower corporate tax rates and lower corporate tax burdens in response to competitive pressure by countries in their region that have previously introduced such measures.

Some countries, most notably in the Asia–Pacific region, have made a clear strategic decision to use their tax systems to entice specific industry sectors to establish both corporate headquarters and production facilities. These incentives are typically provided in the form of tax holidays from corporate taxation, sometimes for periods of up to 10 years. In many cases these countries also have a lower statutory corporate tax rate than Australia.

4. Conclusion

Australia's statutory corporate tax rate and corporate tax burden are becoming increasingly uncompetitive when compared with almost any country grouping that matters.

If these issues are not addressed, there is a risk Australia will see its employment and investment opportunities limited as it becomes increasingly uncompetitive as an investment destination. To the extent that it is practical, Australian companies may seek to relocate business operations to other lower-taxing countries.

Following the publication of its inaugural survey, the BCA called on the federal government to undertake a comprehensive review of the comparative position of Australia's tax burden and the potential ramifications of this uniquely high burden for investment, productivity and growth.

Based on this update of the survey, we reiterate this call.

The review should examine the merits of a range of options for reducing Australia's overall corporate tax burden, from lowering the statutory rate to addressing specific issues regarding the treatment of business income in Australia compared to our competitors.

Although a number of corporate-tax-related issues were examined in the government's *International Comparison of Australia's Taxes*, that review panel was tasked only with comparing Australia's relative position; not recommending solutions. In conducting that comparison, the review confirmed that Australia's tax burden was high when examined against key international indicators. Under its terms of reference, the review was to provide information that would 'help inform discussion about Australia's tax system'. The BCA believes the time for that discussion is now.

The call for a comprehensive review of business taxation in no way suggests that past taxation and related reforms have not been beneficial. However, it is clear from the BCA's research that the international corporate taxation environment is moving very rapidly. With the benefit of hindsight, it seems that the reforms undertaken in 1999 were not bold enough. The facts outlined in this survey, in the context of a rapidly changing global tax environment, highlight that Australia cannot afford to defer making informed decisions in this area.

Major tax reform is never easy. It is a complex and often highly political task. But the BCA considers that a deeper understanding of the tax burden being borne by companies in Australia, together with an understanding of the complexity of business taxation in Australia, will clearly demonstrate the need for a more ambitious business tax reform agenda. Using the above research as an important starting point, we must be prepared to take the necessary steps to keep Australia's corporate tax system competitive if we are to sustain a strong and vibrant business sector capable of underpinning a strong economy.

Appendix

NORWAY AND LUXEMBOURG'S HIGH CORPORATE TAX BURDEN

LUXEMBOURG

Luxembourg has the second-highest corporate tax burden as a percentage of GDP within the OECD and the EU. Luxembourg is unique within the OECD and the EU because of the small size and the nature of its economy. It is a city-state of about 2,500 square kilometres in size with a population of less than half a million.

Over the past decade Luxembourg has been successful at attracting foreign direct investment from global businesses, particularly in the information technology and financial services sectors. Many global businesses use Luxembourg as the location for their European headquarters. The weighting of the economy in respect of these businesses is believed to be the main reason for the relatively high corporate tax burden as a percentage of GDP:

> '... by its size, location and economic structure, the Luxembourg economy has a large external sector. It is therefore necessary to be very cautious when comparing the figures for Luxembourg with the data for the other member states, especially when relating total revenue from taxation with gross domestic income.'[4]

The size and structure of Luxembourg's economy is atypical of the rest of the OECD and the EU and for these reasons it is less reliable as a jurisdiction for comparison.

NORWAY

Norway now has the highest corporate tax burden as a percentage of GDP in the OECD. The reason for this high corporate tax burden is the corporate income tax and the special resource extraction taxation applied to oil and gas production. Norway is the third-largest exporter of oil after Saudi Arabia and Russia, with much of the revenue from this source being invested into a long-term Government Petroleum Fund.

Oil extraction companies in Norway paid more than three-quarters of total corporate tax, 62 per cent of which was a special tax on oil extraction. Norway's corporate tax revenue is therefore boosted by both the price of the oil and the profitability of the oil extraction companies. The key factor in Norway's high corporate tax burden is the oil sector.

Because of these unique characteristics, Norway is also atypical of the rest of the OECD in having such a high corporate tax burden due to revenue from the petroleum industry.

Notes

1 See for example, R Gropp & K Kostial (2001) 'FDI and Corporate Tax Revenue: Tax Harmonization or Competition?', Finance & Development, Vol. 38, No. 2, available at www.imf.org/external/pubs/ft/fandd/2001/06/gropp.htm; M Devereux & R Griffith (1998) 'Taxes and the Location of Production, Evidence From a Panel of US Multinationals', *Journal of Public Economics*, 68, 335–67; Buettner & Ruff, (2005) *Tax Incentives and the Location of FDI: Evidence from a Panel of German Multinationals*; R de Mooij & E Sjef (2003) 'Taxation and Foreign Direct Investment: A Synthesis of Empirical Research', *International Tax and Public Finance*, 11, 673–693.

2 See Y Lee & R Gordon (2005) 'Tax Structure and Economic Growth', *Journal of Public Economics*, vol. 89, 1027–1043.

3 For example, on 17 June 2005 the Australian Government issued an exposure draft detailing proposed measures to provide tax relief for conduit foreign income – income received by a foreign resident through an Australian corporate entity. Under the proposed measures, conduit foreign income will not be taxed in Australia when distributed by the Australian corporate tax entity to its foreign owners.

4 European Communities (2004) '*Structures of the taxation systems in the EU*,' p.185.

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