Taxation plays a fundamental role in providing the right environment for Australian business to operate effectively and efficiently, improving productivity and taking advantage of the increasingly globalised and competitive world. How companies are taxed impacts on a vast array of business decisions, from employment and investment to location. Consequently our taxation system has the potential to have a significant impact on the long-term prosperity of Australia. Australia cannot afford to ignore significant barriers to competitiveness, and our current high personal tax rates and high company tax burden compared with potential trading partners and competitors clearly falls into this category. Unfortunately, clarity of debate regarding the competitiveness of our company 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 has been very little meaningful debate on further corporate tax reform. The complexity of the debate is compounded by those who try to limit comparison 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

Corporate Taxation

AN INTERNATIONAL COMPARISON

Business Council of Australia

A Survey by the
Business Council of Australia

with assistance from

KPMG

OCTOBER 2005

Contents

1. Executive Summary

Taxation plays a fundamental role in providing the right environment for Australian business to operate effectively and efficiently, improving productivity and taking advantage of the increasingly globalised and competitive world. How companies are taxed impacts on a vast array of business decisions, from employment and investment to location. Consequently our taxation system has the potential to have a significant impact on the long-term prosperity of Australia.

Australia cannot afford to ignore significant barriers to competitiveness, and our current high personal tax rates and high company tax burden compared with potential trading partners and competitors clearly falls into this category. Unfortunately, clarity of debate regarding the competitiveness of our company 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 has been very little meaningful debate on further corporate tax reform.

The complexity of the debate is compounded by those who try to limit comparison 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.

This inaugural survey has been undertaken by the Business Council of Australia (BCA) to shed light on an area that is crucial for Australia's long-term prosperity.

The BCA represents the chief executives of 100 of Australia's leading companies. These companies account for a substantial share of Australia's domestic and overseas business activity. Our Members therefore have a significant interest in supporting public policy reform that positions Australia as a strong and vibrant economy and society. It is the BCA's objective to develop and advocate, on behalf of its Members, such reforms.

Over the past year, the BCA has focused its energies on developing and articulating an integrated reform package centred around four key policy areas: workplace relations, taxation, infrastructure and business regulation. Combined, these four areas will play a major role in determining the rate of Australia's future growth.

As an organisation representing the chief executives of Australia's largest companies, the BCA is in a unique position to understand the consequences of an uncompetitive taxation system. It is vital that this area be better understood and the BCA confirm its argument that company taxation and the treatment of business income must be reviewed and assessed against the current competitive environment. This is not an area where we can afford to ignore the facts and wait until the consequences are upon us.

This survey 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.

A clearly identifiable pattern emerges when Australia is compared to these groups of countries. In most purely statutory rate comparisons, Australia's corporate tax rate of 30 per cent is generally comparable with the averages. However, in comparison to the highly competitive EU countries Australia's statutory corporate tax rate is substantially higher than the average of 25.3 per cent.

A different picture emerges when looking at Australia's corporate tax burden. In fact, Australia's corporate tax burden is considerably higher than the averages of all competitor 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 outcome is of significant concern as the corporate tax burden is considered a more complete measure of economic competitiveness.

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.

This survey of corporate taxation trends indicates that Australia's corporate tax burden is already too high in the current global economy and that Australia's competitive position is deteriorating.

If this issue is not addressed, 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.

- Corporate tax rates are a significant determinant of Australia's economic competitiveness and prosperity.
- Australia's corporate tax burden as a share of GDP is higher than every relevant comparable country including current and future potential competitors.
- Australia's corporate tax burden as a share of GDP is increasing at a greater rate than profit share, while other countries are striving to become more competitive in this area.
- Australia's high corporate tax burden as a share of GDP cannot be explained by factors such as the high profitability of Australian companies, the availability of losses or Australia's dividend imputation system.
- More than one-third of OECD member states and more than one-third of EU member states have reduced their statutory corporate tax rates in the last twelve months. Importantly, when the business tax reforms came into effect in 2001, Australia's statutory corporate tax rate was below the OECD and EU averages; in 2005 it is now above both of these averages.
- Australia must reduce its corporate tax burden in order to maintain its competitiveness and create opportunities for future generations.

The significance of these competitive barriers should not be taken lightly. The Australian Government relies heavily on corporate taxation revenue. Company taxation is the second largest revenue stream and the fastest growing (company tax receipts have risen from $27.1 billion in 2001–02 to an estimated $48 billion in 2005–06) for the Federal Government. A company tax system that constrains rather than promotes the future prosperity of business and the economy will have revenue-adverse consequences. Without a strong company taxation revenue stream, future Australians will not be able to afford the same level of services that they currently enjoy. Perhaps even more alarming for Australia's future prosperity is that an unhealthy business sector could result in Australia not being able to afford other much-needed reform measures, such as the reduction in our aggressively high personal taxation rates.

Given these facts it is imperative that the Australian Government gives this issue full and timely consideration. In April 2005 the BCA strongly recommended that the Government review the company tax system (both the treatment of business income and the statutory rates) within the context of the global environment to assess and remove pressure against Australia's competitiveness. This is not an area where Australia can afford to ignore the facts any longer.

This survey aims to provide some facts as a basis for review and debate.

2. Introduction

2.1 | A PROSPEROUS FUTURE FOR AUSTRALIA

Australia is a prosperous nation with GDP per capita above the OECD average as shown in Figure 1. Australia's economic performance compared with the OECD average has improved from a significant slump in the 1970s and 1980s. The reforms undertaken in the 1980s and 1990s including: the floating of the Australian dollar in 1983; tariff reform in the late 1980s; ongoing labour market reform; National Competition Policy; and the reform or privatisation of a number of major Government entities have contributed to Australia regaining its place in the top third of OECD per capita incomes (see Figure 2). The prosperity resulting from these reforms can be seen in the many benefits that Australians now enjoy including:

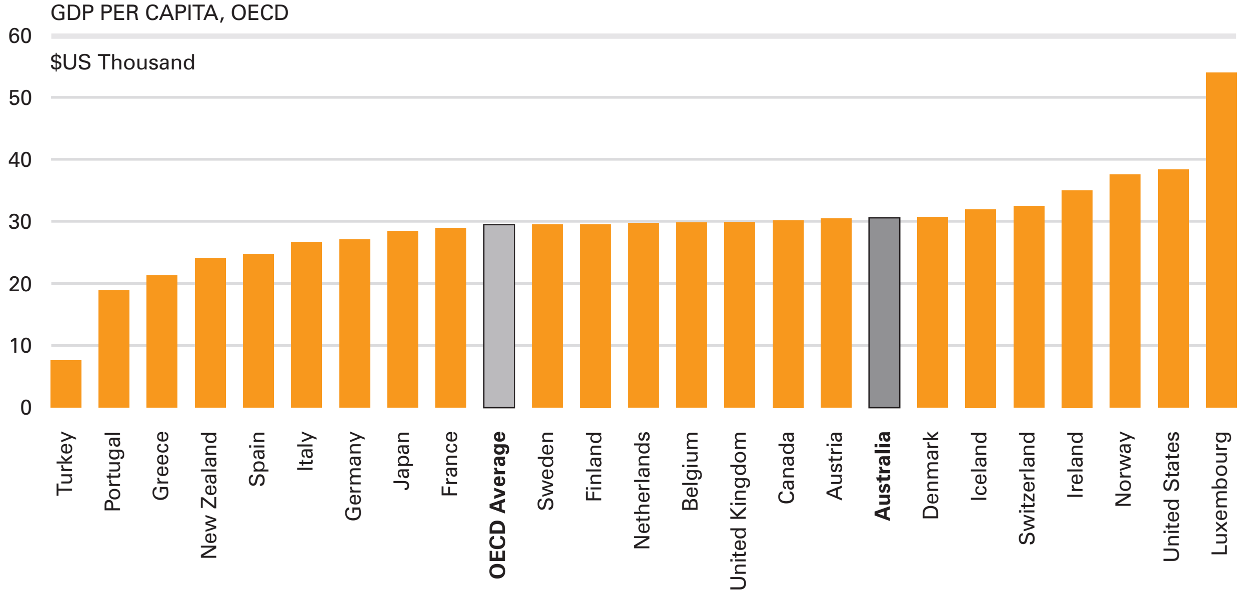
- the average Australian is better off in terms of real wealth by more than $83,000 (in today's dollars) as a direct result of the economic reforms of the last 20 years;[1]
- the high growth over the last five years as a result of these reforms has resulted in greater opportunities and economic protection for Australians;[2]
- the maintenance of a better education and health system than was available 20 years ago; and
- a number of years of strong job growth and low unemployment. The unemployment rate is currently approximately 5 per cent and the economy has produced 403,000 new jobs in the past year. Without the reforms undertaken since 1983, unemployment in Australia would have been 8.1 per cent in 2003–04 compared to the rate of 5.8 per cent. This equates to 315,000 more people in jobs.[3]

1 Business Council of Australia (2005), *Locking in or Losing Prosperity: Australia's Choice.*

2 The last 20 years have seen a shift to increasing progressivity in the treatment of welfare and the taxation system, see Harding, Ann (31 March 2005) 'Recent Trends in Income Inequality in Australia', Presentation to conference on 'Sustaining Prosperity: New Reform Opportunities for Australia', Melbourne.

3 Business Council of Australia (2005), *Locking in or Losing Prosperity: Australia's Choice.*

FIGURE 1
GDP PER CAPITA, OECD



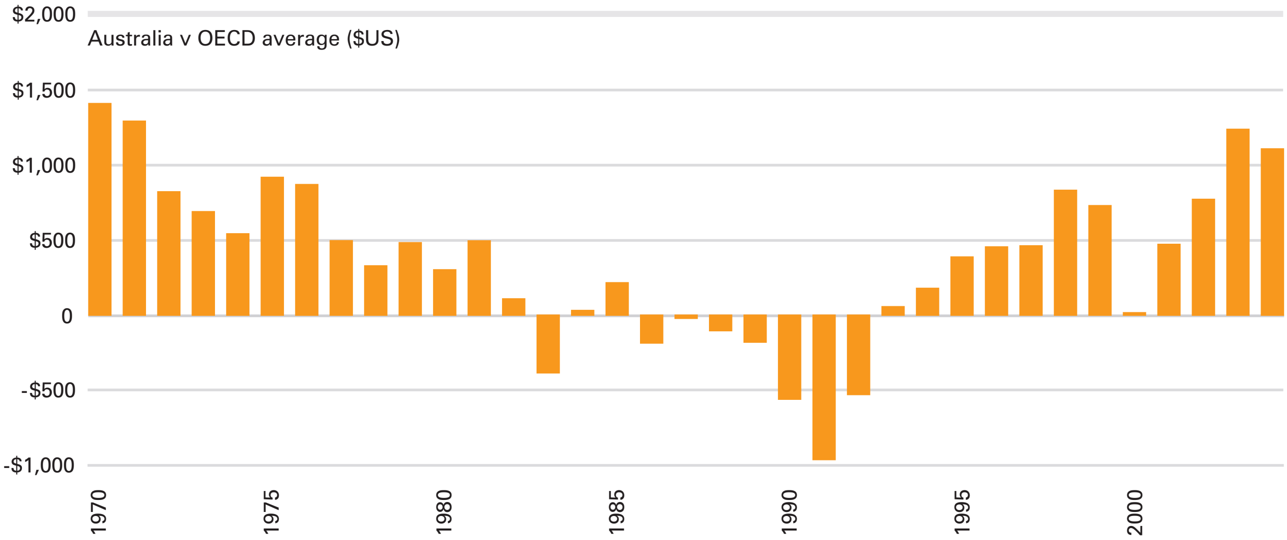
Source: Groningen Growth and Development Centre and The Conference Board, Total Economy Database, August 2005, http://www.ggdc.net

Without a clear reform agenda these benefits will not be sustainable. Australia faces a number of challenges to future growth including increasing globalisation and an ageing population. These challenges will impact on other areas such as our high levels of household debt and debt servicing, which will be manageable only if income and jobs growth remains strong. Australia needs to proactively work towards the outcomes we want for our future. If we do not, then we risk losing all that we have achieved over the last two decades.

Even at this point where Australia is experiencing a high level of prosperity, Australia could be doing significantly better. Figure 3 shows that Australia's labour productivity is significantly below that of most of its key competitors. Australians work long hours already (and therefore would not have much capacity to increase work levels if needed). It is not a question of Australians working harder but Australians working smarter. This requires the right infrastructure, training and business environment and the capacity to move into more productive, high-value areas.

Australians want to live in a vibrant society, one that provides both security and opportunity now and into the future. They want to know that future generations will have the same or better opportunities than they have. They want an economy that will weather global economic cycles and take advantage of the increasingly globalised competitive world.

FIGURE 2
GDP PER CAPITA GAP WITH OECD AVERAGE



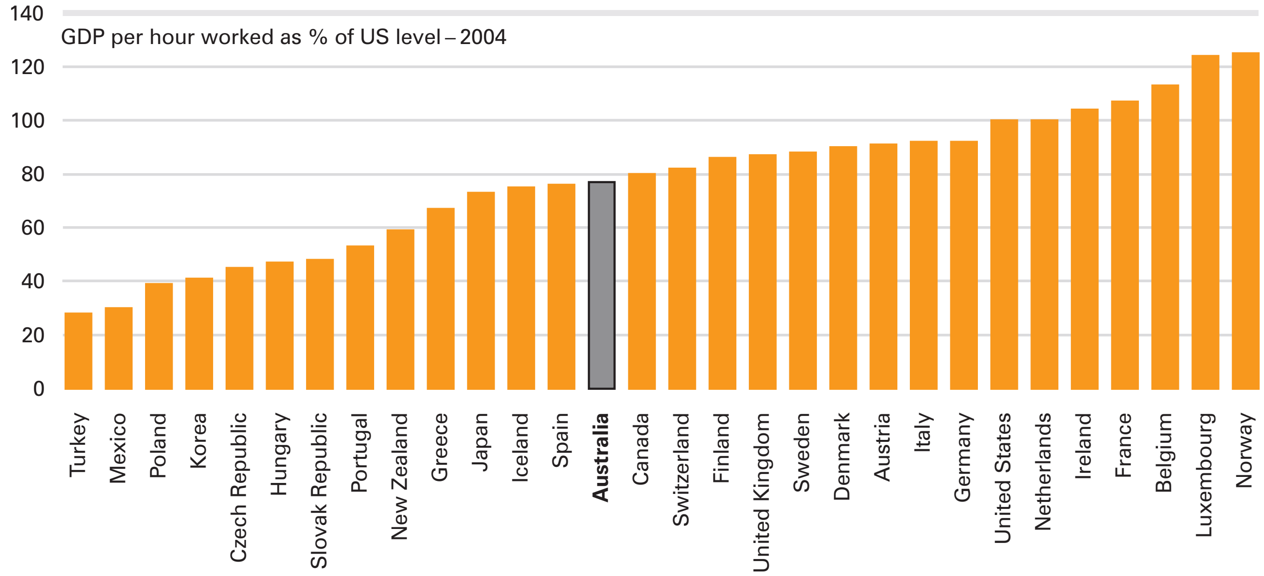
Source: Groningen Growth and Development Centre and The Conference Board, Total Economy Database, August 2005, http://www.ggdc.net

Australians want a future that offers their children and grandchildren:

- not only jobs but also potential for advancement in them;
- good education prospects and a system that supports the economy and employment;
- a medical system that supports society, including its ageing population;
- a safe and secure environment in which to raise families; and
- an Australia that is an exciting and attractive place to live; attracting new people and new ideas, with a healthy society and an environment of strong cultural and creative arts.

We need to foster an economy that is both vibrant and versatile; an economy that has the flexibility to move into new areas as opportunities arise. The economic environment needs to be one where individuals are able to take advantage of competitive situations rather than get overtaken by them. For example, as the global trading environment becomes increasingly competitive with the rise of trading giants such as China (and others potentially in the future such as India), Australia needs to continually reposition itself towards the high-value-added end of the market.

FIGURE 3
LEVEL OF LABOUR PRODUCTIVITY – OECD COUNTRIES



Source: OECD (2005)

We need to ensure that we have access to creative ideas; the right capital investment and capacity for capital deepening; high workforce participation; and access to highly skilled workers. It is vital that we grow and develop new strengths, both building on our existing strong industries and branching into new areas.

To have this potential we need to operate within a framework that does not constrict our flexibility, our innovation or our productivity.

The taxation system is a vital part of this framework.

The operation of Australia's taxation system, including its burdens, structure and how the system is administered, from the taxation of individuals through to how we tax business, investment and savings, is vital to the prosperity the economy.

The future of Australia's prosperity through a strong economy depends on the health and flexibility of business. A robust business sector is vital. Taxation plays a fundamental role in providing the right environment for Australian business to operate effectively including improving on productivity and taking advantage of the increasingly globalised and competitive world. How companies are taxed impacts on a vast array of business decisions. These decisions include staffing, investment levels and location. Taxation also impacts on business capacity to undertake capital deepening, innovation and riskier projects offering higher rewards. Consequently, the taxation system has the potential to have a significant impact on the immediate and long-term prosperity of Australia.

It is widely accepted that Australia taxes its individuals at rates that are too high to support the competitive framework needed. The personal tax system has incentive impacts that flow right through the economy, influencing our overall productivity, incentives to participate, incentives to save and invest and either increasing the cost of hiring or decreasing the individual's take-home wage.

Also critical for Australia's prosperity is an area that is less well understood: the extent of the tax burden on Australian companies compared with all of its competitors and the likely long-term impacts of this for Australians if these burdens are not addressed in the near future.

This survey has been initiated by the BCA to highlight an area that is not well understood in the broader community and that has been avoided by our leaders as politically difficult. Given the fundamental role that Australian business plays in improving the prosperity and competitiveness of the nation it is vital that this area be better understood.

As an organisation representing the chief executives of 100 of Australia's largest companies, we are in a unique position to understand the consequences of an uncompetitive corporate taxation system. The BCA remains adamant that company taxation and the treatment of business income must be reviewed and assessed against the current competitive environment. This is not an area where we can afford to ignore the facts and wait until the results of a lack of reform have already made their impact.

2.2 | RECENT CHANGES IN AUSTRALIAN CORPORATE TAXATION

The reluctance to debate the issue of the corporate taxation burden is likely to be partly due to 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. The Government accepted the recommendations of the 1999 Review of Business Taxation (the 'Ralph Report') to reduce Australian company tax rates from 36 per cent to 30 per cent. This change was overdue given the extent of movement already occurring internationally, but was undertaken as a strictly revenue neutral reform. By definition the reforms were undertaken so that they would not lower the overall burden of taxation that companies faced.

The changes in company tax rates were funded 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 six years later the benchmark set by our competitors has moved on. Today, Australia's statutory corporate rate is just above the OECD average.

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 forgone such as accelerated depreciation, have been far more costly for business and have produced a far greater gain to Government revenue than anticipated by either business or the Government. Despite the reforms the taxation burden facing companies has increased over the last five years.

Analysis of company accounts in 2005 found that the top 150 companies paid corporate tax at an effective rate of approximately 27 per cent in 2004, compared with the statutory rate of 30 per cent.[4] This effective rate in 2005 is now almost the same as 1986, when the largest companies paid an average of 28 per cent tax on profits, despite a prevailing corporate tax rate of 46 per cent.

2.3 | STATUTORY RATE COMPARISONS ARE ONLY PART OF THE PICTURE

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. In Australia's case the removal of many concessions as part of business taxation reform means that unlike many countries with a lower corporate tax burden, the statutory rate and the corporate tax paid are almost identical.

A low statutory corporate tax rate sends a clear signal to global business – perhaps the simplest example being the decision by Ireland to lower its statutory corporate tax rate to 12.5 per cent several years ago. However, global investment decisions are generally not made solely on the basis of the statutory rate without an assessment of the actual burden of taxation and the complexity of respective taxation systems.

4 *'Business tax burden too high'* and *'Push to ease growth in corporate tax'* (29 March 2005), Australian Financial Review.

2.4 | WHY A HIGH CORPORATE TAX BURDEN IMPACTS ON AUSTRALIA'S FUTURE PROSPERITY

The prosperity of Australian business impacts on the number of jobs available, the range of goods and services offered and the extent of the size of the revenue pool available for Government to use in the provision of services such as health, education, an effective and equitable welfare safety net, and sufficient infrastructure for a growing economy and security. The size of the available revenue pool will also impact on the capacity for Government to undertake a much-needed reform agenda including personal tax.

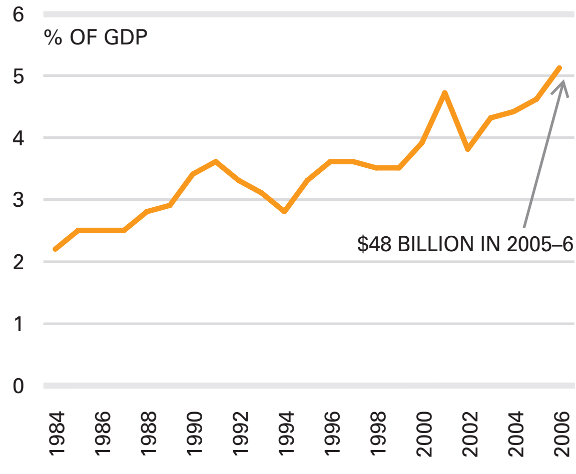
Figure 4 shows the extent to which Government is increasingly relying on the high corporate tax take for a range of spending and reform initiatives. The corporate tax take is the second biggest revenue stream to the Commonwealth, and the fastest growing. Company tax receipts have almost doubled from $27.1 billion in 2001–02 to an estimated $48 billion in 2005–06.

Company tax rates and burdens are crucial to the health and performance of the corporate sector. There are a number of factors involved in business decisions but taxation is consistently listed as one of the most important factors in the all-important decisions such as where to locate, whether and how to invest and whether to hire.

A high corporate tax burden is significant for several reasons.

- First, recent economic research has indicated that there is an inverse relationship between the tax burden and productivity. The higher the tax burden, the lower the productivity.[5] This is thought to be because the burden of taxes reduces the incentive for business to invest and innovate and unduly interferes with the allocation of resources in a market economy. Recent research comparing the EU with the US[6] and in the UK[7] confirms that higher tax burdens can be associated with lower productivity and lower rates of economic growth.
- Second, and crucial for Australia in the immediate term, high tax burdens deter investment.[8] High corporate tax rates act as a deterrent to foreign investment inflows and act to encourage the outflow of foreign investment from Australia to lower-taxed jurisdictions. Globalisation is increasing the mobility of capital and Australia must remain competitive to attract foreign inflows of capital, particularly with the global significance and geographic proximity of China, India and Singapore.

FIGURE 4
COMPANY TAX AS A SHARE OF GDP



Source: Commonwealth Budget Papers

IMPACTS ON INVESTMENT

In an increasingly globalised economic environment characterised by highly mobile capital and increasingly mobile labour, tax rates are an important consideration in making investment decisions.

The Federal Government recognises the importance of Australia's taxation system in the context of global competition:

> 'The Government is very conscious of the need to strive constantly to put in place a competitive business environment – with the taxation regime, education policy, innovation policy and flexible labour markets all vitally important'.[9]

The attractiveness or otherwise of a taxation regime can make a vital difference for global businesses in setting their investment priorities. This competition to attract investment is well understood in Europe. For example, as mentioned earlier, over the past decade Ireland has attracted substantial foreign direct investment and achieved dramatic economic growth by reducing its corporate tax rate. New EU member states, principally those in central and eastern Europe have adopted a similar tax strategy in order to attract investment. In Europe this competitive pressure has led other countries to respond by either reducing their statutory corporate tax rates or adopting other measures to attract and retain investment.

5 See Blackman, M. *How International Tax Rates Impact Your Investments*, 14 July 2004, available at www.investopedia.com/articles/04/071404.asp

6 Bergström, F and Gidehag, R. EU Versus USA, a report by Timbro, available at www.timbro.com/euvsusa/pdf/EU_vs_USA_English.pdf.

7 www.reform.co.uk/website/economy/quickbrief.aspx.

8 See Gropp, R. and Kostial, K., 'FDI and Corporate Tax Revenue: Tax Harmonization or Competition?', 'Finance & Development', 2001, Vol 38, No. 2, available at Gropp and 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; Devereux, M. and R. Griffith (1998), *Taxes and the Location of Production, Evidence From a Panel of US Multinationals*, Journal of Public Economics 68, pp. 335–67; Buettner and Ruff, Tax Incentives and the Location of FDI: *Evidence from a Panel of German Multinationals*, available at www.bundesbank.de/download/volkswirtschaft/dkp/2005/200517dkp.pdf

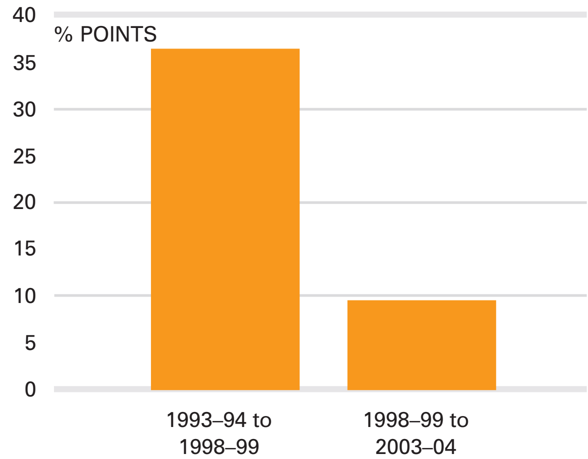
9 Department of Foreign Affairs and Trade (2002), *The Big End of Town and Australia's Trading Interests*, p. iii.

The International Monetary Fund has made the observation that the countries experiencing revenue declines offered the least attractive corporate tax regimes within the OECD.[10] Countries such as Germany and Japan that had relatively high corporate tax rates, low foreign direct investment inflows and high foreign direct investment outflows also experienced declining corporate tax revenues. Modelling supported the proposition that reducing corporate tax rates would result in increased foreign direct investment, while increasing corporate tax rates would result in reduced foreign direct investment. Because of the investment response to the corporate tax rates, countries which reduced high corporate tax rates would also experience gains in corporate tax revenue.

Figure 5 shows the percentage change in the ratio of the level of foreign equity investment to GDP in Australia over the two five year periods 1993–94 to 1998–99 and 1998–99 to 2003–04. Foreign equity investment is a major component of foreign direct investment. The changes in these ratios reflect real foreign investment transactions, that is the data removes the impact of swings in the value of equity due to factors such as price or exchange rate changes.

The figure shows that investment inflow growth has declined substantially since the end of the 1990s. From 1998–99 to 2003–04, foreign equity investment in Australia increased by just 10 percentage points of GDP. In contrast, in the preceding five year period to 1998–99, foreign equity investment increased by 37 percentage points of GDP.[11]

FIGURE 5
PERCENTAGE POINT CHANGE IN
FOREIGN EQUITY LIABILITIES TO GDP RATIO



Source: ABS 5302.0

10 Gropp, R. and Kostial, K. (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.ht

11 Data for 2004–05 is not included in Figure 5 because of the large but offsetting transactions associated with only one company, the change by News Corporation from being an Australian to a United States domiciled company.

2.5 | AUSTRALIA'S HIGH CORPORATE TAX BURDEN: SOME COMMON MYTHS

There are a number of factors contributing to Australia's high corporate tax burden that go beyond an overtaxing system and need consideration in order for there to be clarity in the debate. Each of the following factors makes some contribution to Australia's comparatively high tax burden however it is clear that no individual factor or combination of factors can be used to account for the significant difference in taxation burden. Australia taxes its companies at a highly uncompetitive level even taking into account these factors.

MYTH 1: Australian Companies' Strong Profit Growth Is The Key Driver In Australia's High Corporate Tax Take.

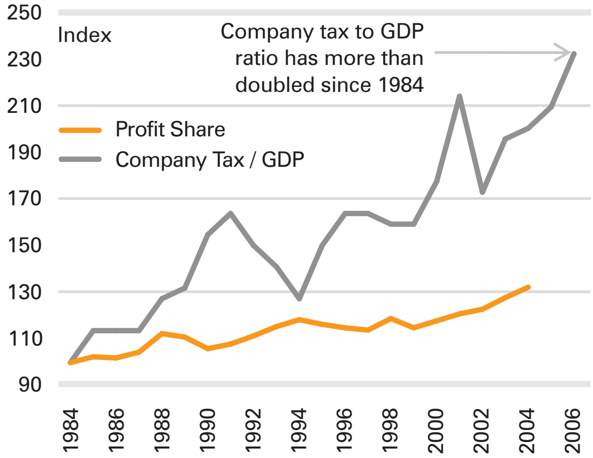
One proposition often provided is that Australian companies have had strong profit growth over the last 10 years and this is what is driving the high tax burden in Australia compared with other countries.

This theory assumes that:

- Australian companies have been doing unusually well compared to all of their potential competitors; and
- that the taxation burden correlates to company profit share.

Figure 6 shows the comparison of company tax take with Australian company profit share. While Australian companies are doing well it is clear that the increase in taxation burden is growing at a rate that is significantly above the rate of growth in company profit share.

FIGURE 6
COMPANY TAX AND PROFIT GROWTH



Values taken in June of each year

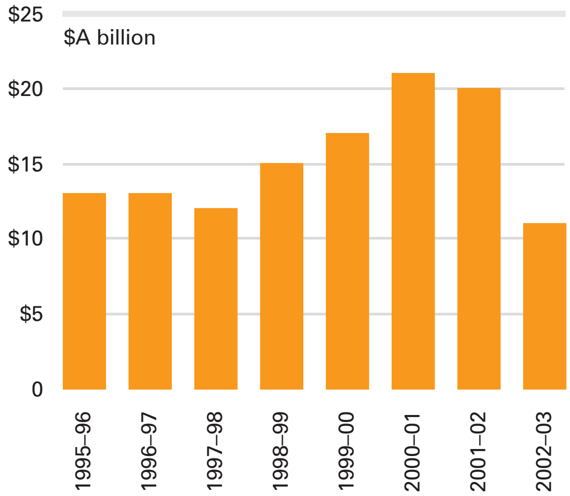
Source: Profit share (profits as a share of total factor income) – ABS; Company tax – Commonwealth Budget Papers.

MYTH 2: Australian Co anies No Lon er a e Losses

Another proposition sometimes advanced to explain Australia's high company tax burden is that Australian companies have been so profitable for so long that they no longer have any losses to carry forward against their income. The ability to use deductions is a combination of both availability of the deductions (treatment of business income) and capacity to use them. The most recent ATO Taxation Statistics[12] reports tax losses 'transferred in' from one company in a corporate group to another company in the corporate group with a total value of almost $11 billion in 2002–03 (see Figure 7).

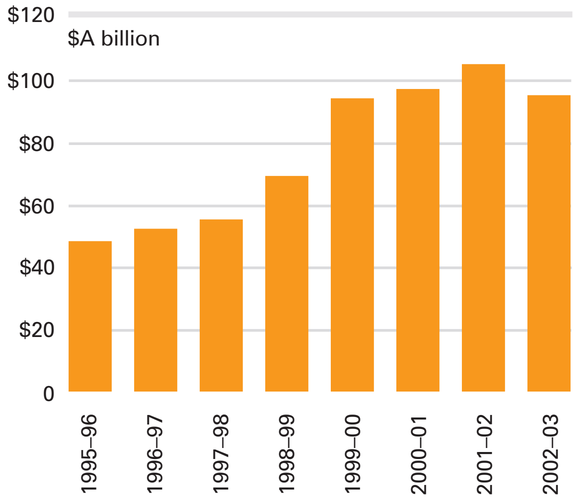
Company tax losses carried forward in 2002–03 had a total value of almost $95 billion. It is clear from Figure 8 that there is no lack of available losses for utilisation against taxable gains. It is not accurate to suggest that these losses are not being made or even that their use has declined substantially. If there has been any decline in the use of losses this can be attributed to further tightening of eligibility criteria for loss utilisation (such as the stricter continuity of ownership and same business test rules and the entry provisions for the corporate tax consolidations regime) possibly constraining the ability of companies to utilise these losses.

FIGURE 7
COMPANY TAX LOSSES 'TRANSFERRED IN'



Source: Taxation Statistics 2002–03, Table 4.10, ATO (2005)

FIGURE 8
COMPANY TAX LOSSES CARRIED FORWARD



Source: Taxation Statistics 2002–03, Table 4.10, ATO (2005)

12 Australian Taxation O ce (2005), *Taxation Statistics 2002–03*, .69.

MYTH 3: Australia's Dividend System Drives The Corporate Tax Burden

A key change to corporate taxation included with the 1980s 'Reform of the Australian Tax System' was the introduction of dividend imputation. Imputation provides Australian resident shareholders with a tax credit for corporate tax paid. This system ended the double taxation of company profits, previously taxed at both the corporate level and then again when received as dividends by shareholders. The introduction of imputation, combined with a capital gains tax, encouraged companies to declare and distribute dividends to shareholders rather than retaining the profits within the company. Dividend imputation also provided an additional incentive for Australians to invest in shares as an asset class.

The impact of Australia's system of dividend imputation is sometimes used to explain the high corporate tax take. The argument is that Australian companies, given a choice between paying tax overseas and paying tax in Australia and facing similar corporate tax rates between Australia and another jurisdiction, are likely to pay it in Australia and therefore increase their capacity to provide franking credits to their Australian shareholders.

For example, an Australian resident financial services firm might structure its business to conduct certain transactions such as contracting loan agreements in Australia rather than overseas in order to have the income Australian sourced, pay tax in Australia, and therefore generate franking credits for the payment of dividends to the Australian shareholders.

While this is likely to occur in some circumstances, and therefore will be a factor in Australia's total corporate taxation burden, the impact should not be overstated. The choice on where to pay tax will depend on the attributes of the comparable country.

Australia is not alone in providing mechanisms for relief from double taxation of dividends. Imputation systems similar to that in Australia are found, for instance, in Finland, France, Mexico, New Zealand and Norway. Most other countries also provide mechanisms for dividend relief at both the corporate and individual shareholder level. At the corporate level dividends are generally effectively treated as exempt income, for example under the US dividend deduction rules or the EU parent-subsidiary directive and individual countries' exemptions. At the individual level, dividend income is commonly either exempted, or taxed at lower marginal rates. Countries offering no or lower dividend tax rates include: Austria, Belgium, Canada, the Czech Republic, Denmark, Germany, Greece, Hong Kong, Hungary, Iceland, Ireland, Italy, Korea, Poland, Portugal, Spain, Singapore, Sweden, Turkey, the UK and the US.

In addition, the franking credit incentive to pay tax in Australia rather than another country – where that choice is feasible – is unlikely to be relevant for choices between Australia and alternative countries where:

- the total effective tax burden is lower in the other jurisdiction;
- companies are not incorporated in Australia; or
- companies have significant foreign shareholders (New Zealand possibly excepted) who obtain no (or limited) benefit from Australian franked dividends.[13]

13 Imputation is less relevant for non-resident shareholders as they are unable to utilise franking credits to offset any Australian tax liability. Instead, franked dividends are not subject to Australian withholding tax to the extent that they are franked. A non-resident's preference between being subject to withholding tax or receiving a franked dividend would depend on the rules to prevent double taxation in their home tax jurisdiction.

MYTH 4: Differences In Measurement Account For Australia's Significantly Higher Corporate Tax Burden

There are always differences in the measurement of the corporate tax burden between different economies. The Government has in the past noted that Australia's burden on companies is 'inflated' compared with other OECD countries by the inclusion of data that they would not normally incorporate. The OECD comparison data appropriately includes taxes on superannuation fund income (including the superannuation surcharge) and the petroleum resource rent tax.[14] These latter taxes comprise only 16 per cent of total corporate tax revenue and even if they were disregarded entirely from the calculations, Australia would still have a corporate tax burden of 4.4 per cent, well above most comparison economies (see Table 1).[15]

14 These types of taxes are normally included in the corporate tax burden of other countries. If they were disregarded for Australia they would also need to be disregarded for other jurisdictions. Fringe benefits tax, which is a tax paid by companies, is not included by the OECD in the Australian corporate tax burden calculations.

15 Commonwealth Treasury (2005), *Pocket Brief to the Australian Tax System*.

TABLE 1
CONTRIBUTIONS TO THE TOTAL TAX BURDEN

	2003–04 ($m)	% of total corporate tax	% of GDP
Corporate income	36,101	84	4.4
Superannuation funds	5,551	13	0.7
Petroleum resource rent tax	1,168	3	0.1
Total	42,820	100	5.2

3. Global Developments in Corporate Taxes

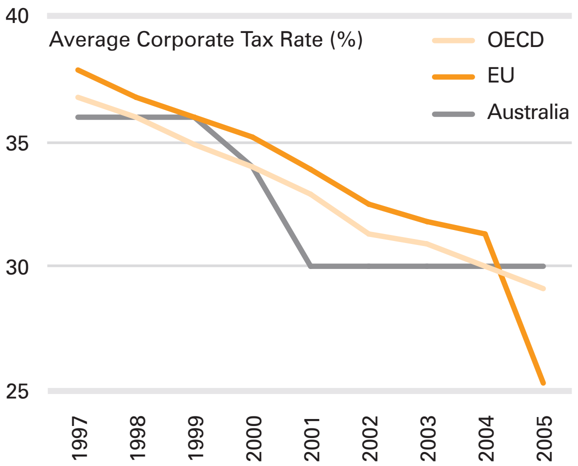
3.1 | TRENDS IN CORPORATE TAX

The current trend in corporate tax rates around the world has been towards reductions (see Figure 9). 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. Other economies, such as Austria and potentially Greece, have in turn responded to this competitive challenge.

Changes to corporate taxes in other major economies have been characterised by a continuing trend towards lower statutory rates. The average statutory corporate tax rate has fallen sharply in the EU due to the accession of 10 new member states in 2005. Eight of the 10 EU accession states, mainly from central and eastern Europe, have statutory corporate tax rates of 25 per cent or less, which has meant a sharp reduction in the average EU statutory corporate tax rate. In addition many of these new EU member states are also further reducing their statutory corporate tax rates in order to attract foreign direct investment. The competitive pressure from entry of these new member states into the EU has also influenced other EU member states to lower or consider lowering their statutory corporate tax rates.

More than one-third of OECD member states and more than one-third of the EU member states have reduced their statutory corporate tax rates in the last year. Importantly, when the business tax reforms came into effect in 2001, Australia's statutory corporate tax rate was below the OECD and EU averages; in 2005 it is above both of these averages.

FIGURE 9
OECD, EU AND AUSTRALIAN HEADLINE CORPORATE TAX RATES



Source: KPMG Corporate Tax Survey 2004

Movements in corporate tax rates in the Asia–Pacific region have been less pronounced than in Europe, but nonetheless the trend has also been towards reduced corporate tax rates. In addition to the generally low headline corporate tax rates, many of the selected economies in the region offer substantial tax concessions that are designed to attract foreign direct investment. These measures including free-trade zones, concessions for 'pioneer industries' and sector-specific concessions for strategic industries are discussed in more detail in section 4.3.

3.2 | 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 three years,[16] these changes are not substantial when viewed against the movements in corporate taxation globally. Importantly, Australia's recent changes do not address the rate or burden companies face. The following are some of the most recent developments among some of Australia's key competitors.

CHINA

On 20 January 2005, China announced a program of company tax reform based on reducing the rate (a rate of 25 per cent is currently under consideration) and increasing the base through measures such as providing a unified corporate income tax rate for domestic and foreign-funded companies and phasing out tax incentives for foreign companies. The process is expected to be completed in one or two years but may have a transition period of up to 10 years.

EU MEMBER STATES

EU member states are currently undertaking measures to transpose a number of EU directives into their respective national laws. These changes include requiring EU member states to abolish withholding tax on some intra-group interest and royalty payments as of 1 January 2004; reducing the minimum shareholding requirement on a phased basis from 25 per cent to 10 per cent; credit relief for taxes incurred by lower-tier subsidiaries; and additions to the list of entities that can benefit from the provisions of the directive.

FRANCE

On 20 June 2005, the French Government announced significant tax breaks for institutions and individuals that invest in Alternext, a new stock exchange for small and medium-size companies. France will offer individual investors a 25 per cent tax credit on the total sum of their investments in Alternext companies and a capital gains tax exemption for institutions that sell shares on those companies.

On 12 July 2005, France announced a €1.5 billion package of tax breaks and incentives for research and development activities that would strengthen the economy and dissuade companies from moving abroad. The plan will create 67 'competitiveness centres' in regional clusters across the country. The 2005 Finance Act created a business tax credit for companies that carry out industrial, scientific, or technical research activities or management, engineering, or information technology activities in designated high unemployment zones. The tax credit will be available to 2011 and is equal to €1,000 per year for each employee that has been employed for more than one year since 1 January.

The 2005 Finance Act and the amended 2004 Finance Act, published in the official journal on 31 December 2004, reduced the 3 per cent surcharge on corporate income tax to 1.5 per cent for fiscal years ending in 2005, and is repealed for fiscal years ending on or after 1 January 2006. The change in the surcharge rate reduces the overall effective rate from 35.43 per cent to 34.93 per cent in 2005 and 34.43 per cent in 2006.

GREECE

The Greek Government is expected to announce a tax reform program in September 2005 that will introduce a flat rate of income tax for corporate and individual income within the next two years. The new flat tax rate of 25 per cent is expected to be introduced on 1 January 2007 and apply to income earned in 2006. The expected reduction in corporate tax rates from the current 38 per cent to 25 per cent has been driven by national competitiveness concerns in response to business tax reform in the new EU member states.

KOREA

From 1 January 2005, the corporate income tax rate was reduced by 2 per cent to 27.5 per cent as part of the Korean Government's measures to stimulate corporate investment in Korea. This is in addition to measures effective from 1 January 2004, which ensure that services provided outside of Korea (even if used in Korea) will no longer be treated as Korean source income and therefore will not be taxed by Korea.

MALAYSIA

The Government of Malaysia is providing new tax incentives to encourage the growth of real estate investment trusts (REITs), or property trust funds (PTFs), with effect from year of assessment 2005. Under the new provisions, the chargeable income of REITs or PTFs that have been distributed to unitholders will be exempt from income tax. Distributions to non-resident unitholders will be subject to 28 per cent withholding tax.

MEXICO

Mexico has reduced its corporate tax rate from 33 per cent to 30 per cent for 2005. This rate will be progressively reduced by one percentage point per year to 28 per cent in 2007. Mexico's Congress recently approved legislation that would change how the country's state-run oil company, Pemex, is taxed, allowing it to save more of its revenue. Pemex currently finances a third of the country's expenditure, funnelling about 60 per cent of its total revenue to Mexico's finances.

NETHERLANDS

The Netherlands has a split corporate tax regime, with a lower rate of 27 per cent imposed on the first €22,689 of taxable profits and a rate of 31.5 per cent thereafter. Corporate tax rates will be reduced in 2006 to 26 per cent and 30.5 per cent respectively and reduced again in 2007 to 25 per cent and 30 per cent.

POLAND

The Polish Government announced on 21 March 2005 that it would introduce a flat tax of 18 per cent by 2008.

THAILAND

On 20 July 2005, Thailand's Cabinet approved a number of corporate tax breaks and other measures to improve workforce productivity and expand the economy. The proposed measures include a tax deduction of up to 200 per cent that companies can claim to offset the cost of training employees and a 150 per cent tax deduction to encourage companies to create new fringe benefits and living expenses for employees who earn less than THB 7,000 per month.

16 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. Australia's Corporate Taxation Compared

4.1 | 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, 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; and
- foreign direct investment sources. The top 10 countries in terms of foreign direct investment to Australia have been selected for comparison.

OECD

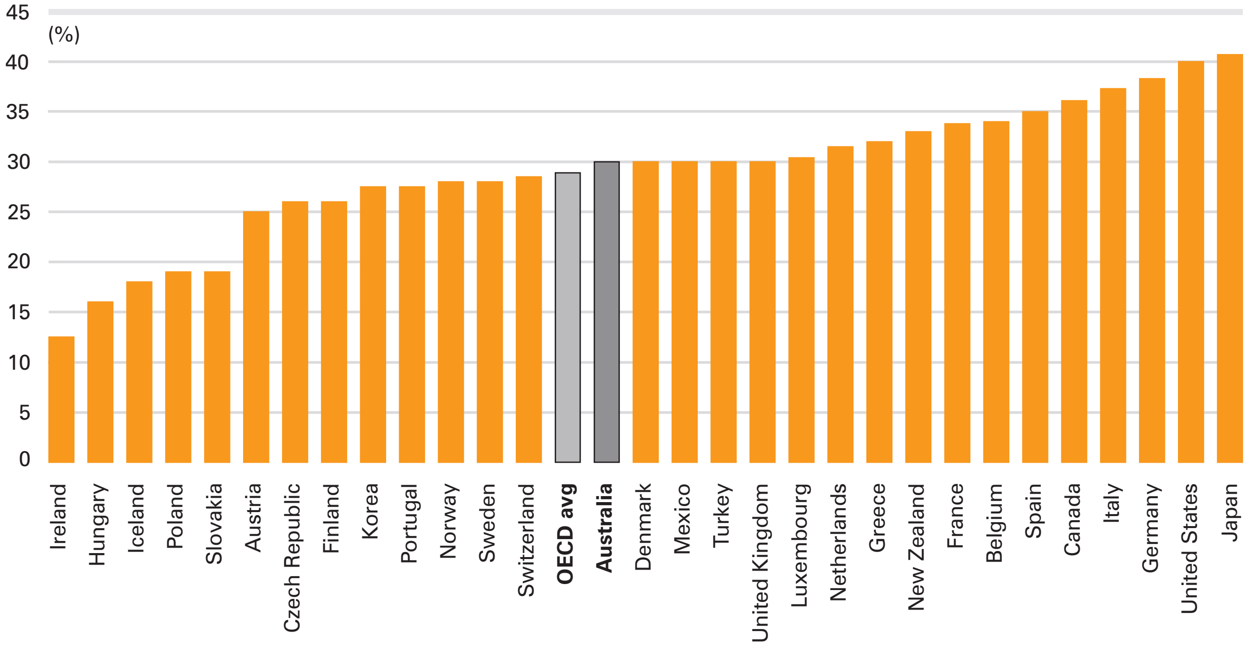
Australia's headline corporate tax rate of 30 per cent compares favourably with the OECD average of 29.1 per cent. However, using the more complete measure of the corporate tax burden, Australia is the third highest in the industrialised world (Figure 11). Australia's corporate tax as a percentage of GDP is 5.3 per cent, significantly higher than the OECD average of 3.4 per cent.

While Australia's headline corporate tax rate compares favourably with the OECD average and is at the median for OECD member economies (Figure 10), it should be noted that the top six countries with the highest corporate tax rates all have very low corporate tax burdens, below the OECD average. Germany (with the third-highest corporate tax rate) and the United States (with the second highest corporate tax rate) have the lowest and third-lowest corporate tax burdens in the industrialised world respectively. Additionally, as outlined above, a number of these countries have announced reforms that will lower the OECD average statutory corporate tax rate in future years, thus widening the gap with 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 then Australia would have the highest corporate tax burden in the industrialised world.

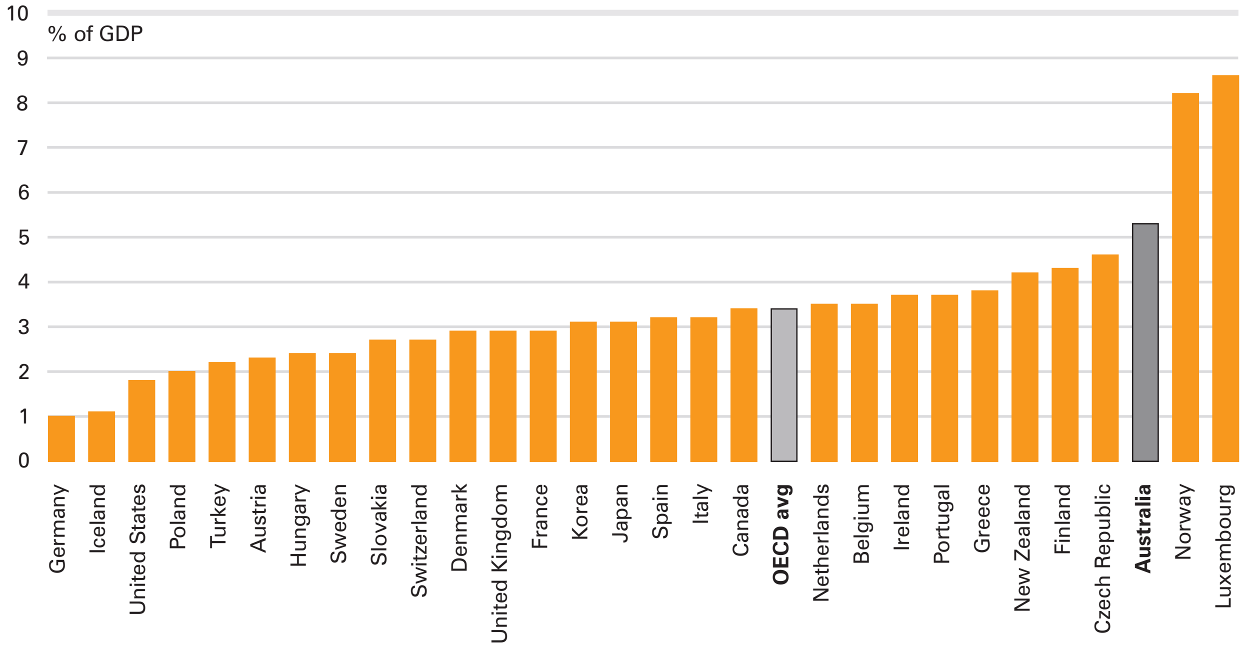
As the second-highest non-OPEC oil-producing country, Norway has significant business tax revenue from North Sea oil and gas production, boosting its corporate tax revenue despite having a corporate tax rate that is below the OECD average. Although Luxembourg imposes a similar headline corporate tax rate as Australia, its high corporate tax burden is largely indicative of the small size of the Luxembourg economy. Australia's GDP is approximately 23 times that of Luxembourg and as such, Luxembourg does not provide a useful comparator for Australia.

FIGURE 10
OECD CORPORATE TAX HEADLINE RATES



Note: Canada, Japan, Switzerland and United States headline rates combine national and average sub-national corporate tax rates.
Source: KPMG Corporate Tax Survey 2004

FIGURE 11
OECD CORPORATE TAX BURDENS



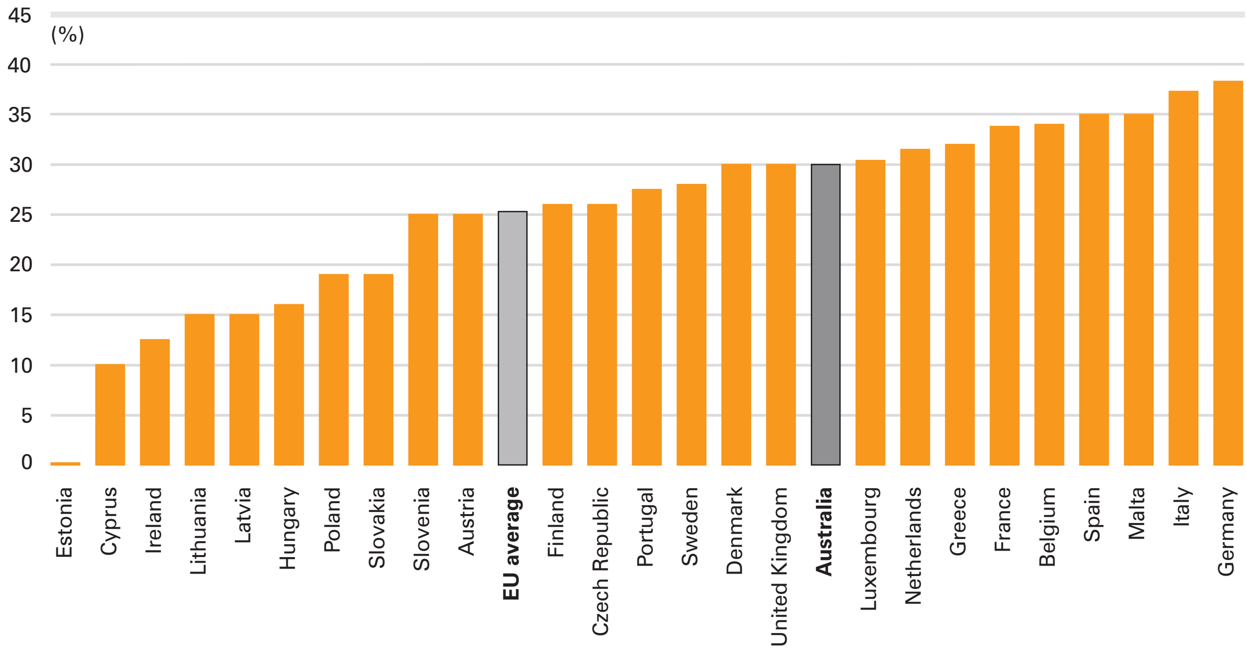
Note: Average does not include Mexico, as disaggregated data for corporate and individual income tax revenue is not available.
Source: OECD Revenue Statistics 1965–2003

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 25.3 per cent (Figure 12). 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. Similarly, Cyprus with a headline corporate tax rate of 10 per cent, being the lowest in the EU (disregarding Estonia), has the second-highest corporate tax burden in the EU (behind Luxembourg). As discussed in the OECD comparison, Germany, with the highest corporate tax rate has the second-lowest corporate tax burden.

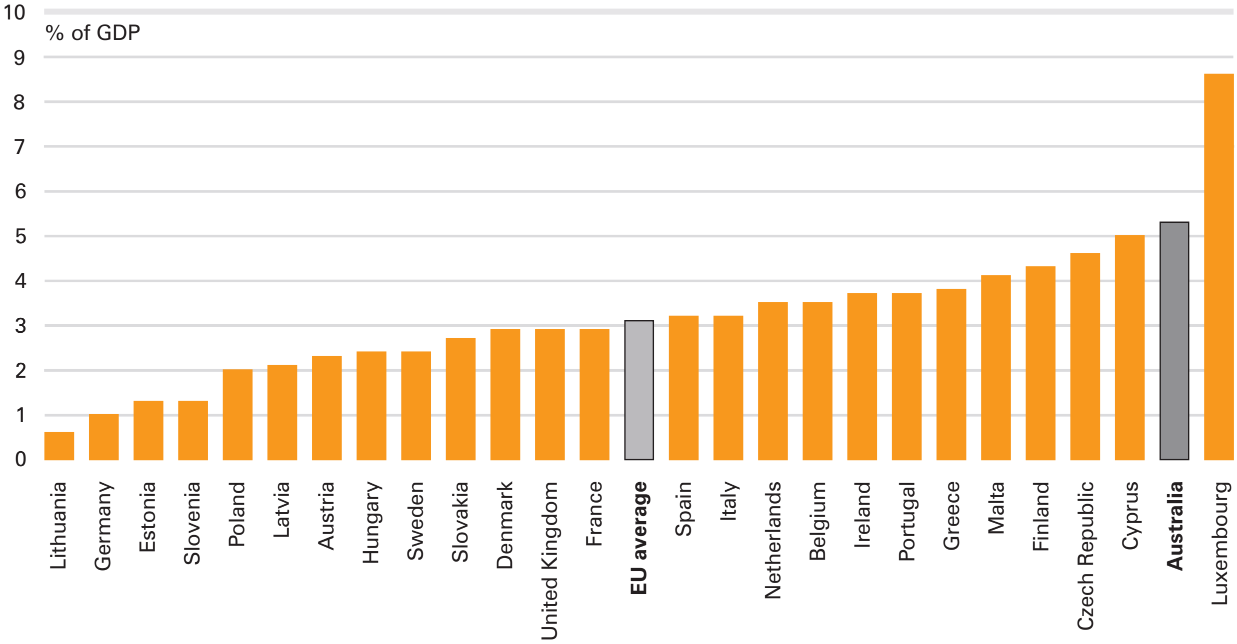
FIGURE 12
EU CORPORATE TAX HEADLINE RATES



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 2004

Comparison of Australia's corporate tax burden with the EU economies reveals that only Luxembourg has a higher corporate tax burden (Figure 13). At 5.3 per cent, the Australian corporate tax burden is significantly higher than the EU average of 3.1 per cent. As noted earlier, Luxembourg is not a good comparator for Australia.

FIGURE 13
EU CORPORATE TAX BURDENS



Source: Structures of the Taxation systems in the European Union, European Communities (2004); OECD Revenue Statistics 1965–2003

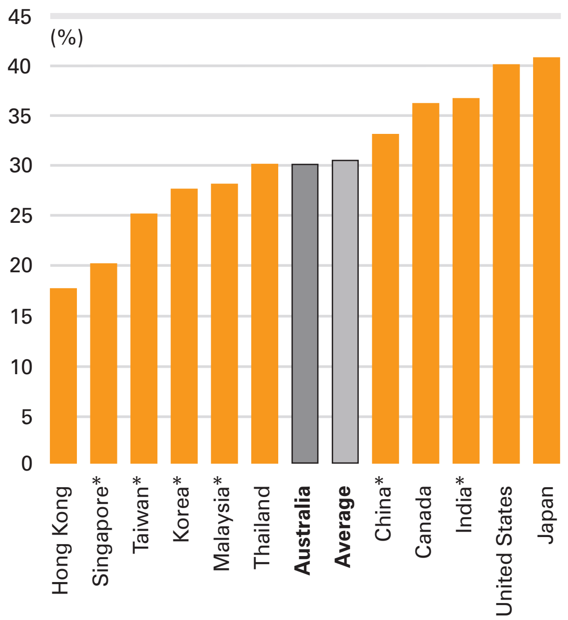
SELECTED ASIA–PACIFIC ECONOMIES

A comparison of Australia's corporate tax rate to key Asia–Pacific economies reveals that Australia's corporate tax rate is slightly lower than the average of 30.4 per cent and at the median in ranking (Figure 14). However, Australia has the highest corporate tax burden of all the selected countries. Australia's corporate tax burden is 5.3 per cent, significantly higher than the average of the selected Asia–Pacific countries of 3.1 per cent (Figure 15).

Further, there is a significant difference between Australia's corporate tax burden and the next highest of the selected economies, being Malaysia.

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, significantly higher than the average for the selected Asia–Pacific economies.

FIGURE 14
ASIA–PACIFIC CORPORATE TAX HEADLINE RATES

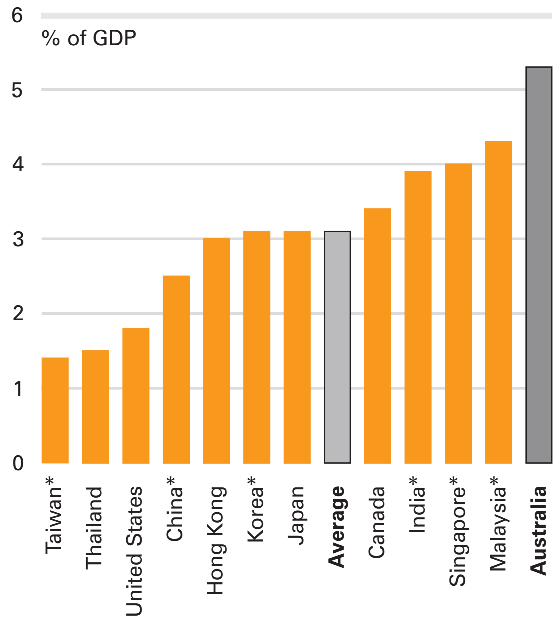


* These economies offer reduced tax rates or concessions as part of their tax regimes.

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

Source: KPMG Corporate Tax Survey 2004

FIGURE 15
ASIA–PACIFIC CORPORATE TAX BURDENS



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

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 1965–2003; Economy budget data

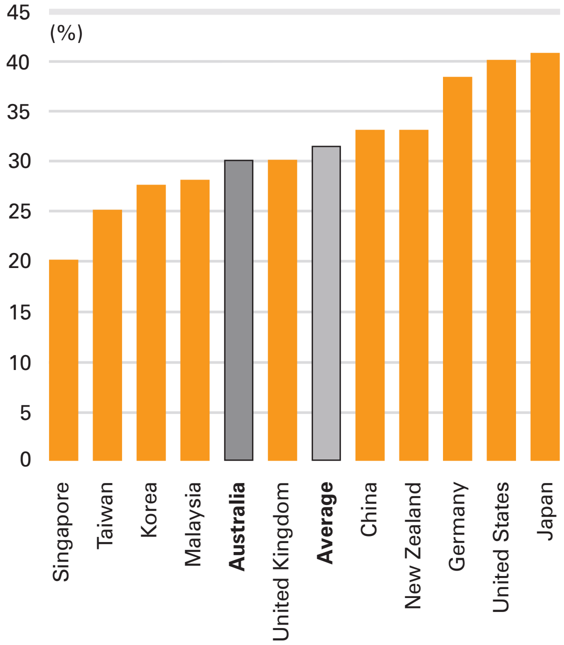
MAJOR TRADING PARTNERS

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 31.4 per cent (Figure 16). However, Australia has the highest corporate tax burden when compared with its major trading partner economies. The average among the trading partner economies is 2.8 per cent, considerably lower than Australia's corporate tax burden of 5.3 per cent (Figure 17).

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 (United States and Germany) have corporate tax burdens well below the average. Singapore with the lowest corporate tax rate still collects a significant amount of revenue from its corporate sector.

Again, there is a significant difference between Australia's corporate tax burden and the next highest major trading partner, being Malaysia.

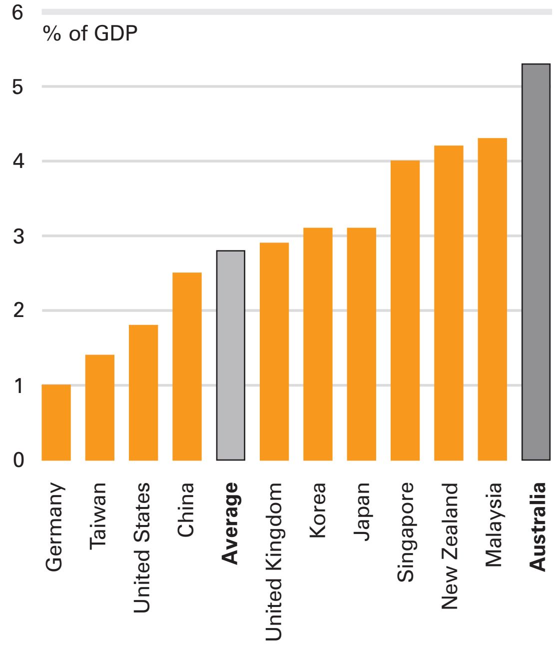
FIGURE 16
MAJOR BILATERAL TRADING PARTNERS
CORPORATE TAX HEADLINE RATES



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

Source: KPMG Corporate Tax Survey 2004

FIGURE 17
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 inlcuded in this calculation.

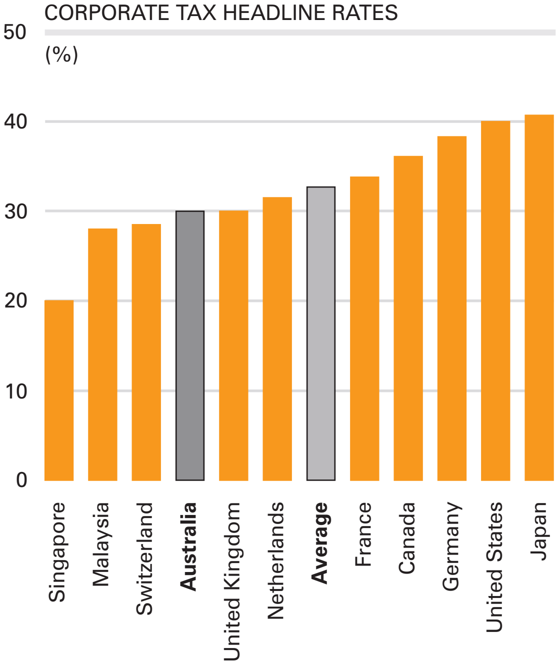
Source: OECD Revenue Statistics 1965–2003; Economy budget data

FOREIGN DIRECT INVESTMENT SOURCES

In common with the other comparisons, 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 (Figure 18).

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 19).

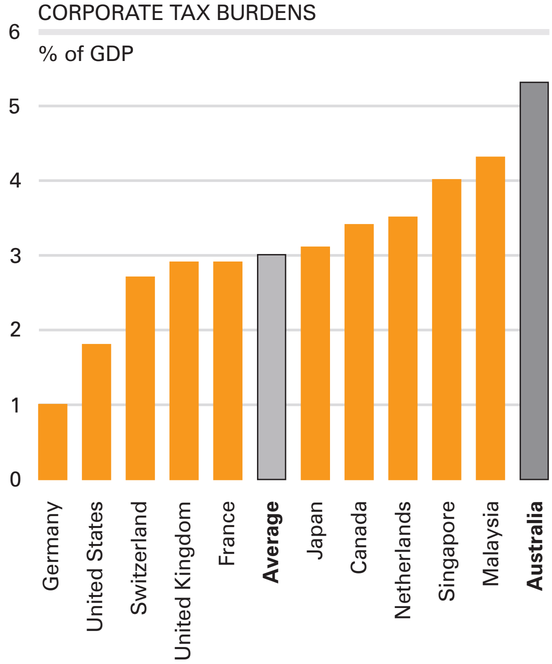
FIGURE 18
SOURCES OF FOREIGN DIRECT INVESTMENT
CORPORATE TAX HEADLINE RATES



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

Source: KPMG Corporate Tax Survey 2004

FIGURE 19
SOURCES OF FOREIGN DIRECT INVESTMENT
CORPORATE TAX BURDENS



Source: OECD Revenue Statistics 1965–2003; Economy budget data

4.2 | AUSTRALIA COMPARED

As the Figures above show a clear pattern emerges when Australia is compared to OECD countries, EU countries, selected Asia–Pacific economies and Australia's major trading partners and key sources of foreign direct investment. 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 25.3 per cent.

However, the statutory rate does not provide the full picture of the impact of Australia's taxation on business decisions. 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 (refer to the Appendix for further discussion), **Australia has the highest corporate tax burden across every relevant global comparison.**

This survey indicates that Australia's corporate tax burden is too high in the current global economy. As discussed in Section 2.4, a high corporate tax burden is potentially detrimental to Australia's future growth and prosperity and as such further corporate tax reform to reduce the corporate tax burden is critical.

4.3 | 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. This would be similar to the position in Australia over 20 years ago, in which the statutory corporate tax was 46 per cent, but the effective rate of tax was closer to 30 per cent as a consequence of various tax concessions.

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 system 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. The use of the tax system as a means of attracting specific businesses or the creation of low tax special economic zones are policy tools that are generally not available under the Australian taxation system because of constitutional constraints.

5. Options for Reform

This survey indicates that Australia's statutory corporate tax rate and corporate tax burden are becoming increasingly uncompetitive when compared with most industrialised economies, EU countries, the Asia–Pacific region, Australia's major trading partners and Australia's major sources of foreign direct investment.

If these issues are not addressed, Australia will become increasingly uncompetitive as an investment destination and, to the extent that it is practical, Australian companies may seek to relocate business operations to other lower-taxing countries.

It is imperative that the Australian Government gives these issues full consideration. In April 2005 the BCA strongly recommended in its *Taxation Action Plan for Future Prosperity* that the Government review the company tax system including the treatment of business income and the statutory rates within the context of the global environment to assess and remove pressures against Australia's competitiveness.

- Six months later the Government has shown no intention of looking at this vital area for Australia's economy. A review of these important issues must be undertaken in the immediate term so that the Government can make informed decisions and address any significant barriers to Australia's competitiveness in the 2006–07 and 2007–08 Federal Budgets.
- The BCA's call for a comprehensive review in no way suggests that the existing and recent business taxation and related reforms have not been beneficial. However, given the facts outlined in this survey and the potential ramifications of a 'do-nothing' policy, Australia cannot afford to defer making informed decisions in this area.

A broad range of issues need to be considered within such a review. These issues are discussed against the assumption that moves are underway to undertake significant and much-needed reform of the personal taxation system, including the reduction in the top two marginal rates to competitive levels. While we are not advocating that there be a reduction in the statutory company tax rate in isolation from broader tax reform, this should not be an excuse for not comprehensively reviewing the current competitive situation for Australia's companies and the impact that Australia's high corporate tax burden is having on our economy now and the implications of this for future prosperity.

The review should consider:

- the current competitive issues and likely longer-term ramifications of continuing with a uniquely high corporate tax burden; and
- the most effective policy measures to address these issues.

TWO OPTIONS FOR REDUCING THE CORPORATE TAX BURDEN

There are in effect two possible broad options for reducing the total corporate taxation burden. One or both options could be used, namely:

- changing the way in which business income is treated in Australia so that it is more comparable with our key competitors;
- reducing the statutory company tax rate to well below the statutory average of our competitors in order to achieve at least an average company taxation burden comparable with our competitors.

OPTION ONE: The Treatment Of Australian Business Income

Investment is highly sensitive to taxation arrangements in Australia. A wide range of uncertainties, complexities and anomalies in the business tax base (such as black hole deductions, non-deductibility of purchased goodwill, treatment of losses and uncertainty surrounding the general anti-avoidance provisions) combine with a relatively unfavourable treatment of tangible investment to reduce Australia's competitiveness. Compared to many other jurisdictions, Australia's tax system is not sufficiently favourable to higher-risk business investment. Given the importance of investment for productivity, particularly in areas such as long-term infrastructure or high-risk projects, measures that both improve the competitiveness of the business taxation system and remove current barriers and distortions to investment, should be considered.

The Australian company tax base is one of the broadest in the world. The reasons for this include the following:

- no write-offs for goodwill acquisitions (tax deductible write-offs are available in many countries including the US and UK);
- depreciation that is close to effective life. In many other countries, capital write-offs for investment in plant and equipment are simplified and accelerated;
- full capital gains tax on companies without discounts or inflation relief; and
- relatively few tax concessions combined with complex specific and general anti-avoidance provisions apply to a wide range of activities including foreign source income, infrastructure investment and capital management transactions.

These and related issues should be looked at specifically for their impact on Australia's current and future competitiveness. The Government needs to ensure that Australia's taxation treatment of business income does not discourage high levels of investment including foreign investment, investment in the more productive areas of our economy, innovation, risk taking and capital deepening.

The country comparison also clearly shows that the countries in the survey with high tax rates often have low corporate tax burdens. From our analysis it is clear that these countries offer a range of tax incentives or tax breaks to support corporate taxpayers. As mentioned above, there is now an extremely limited range of such incentives available in Australia following the Ralph reforms, however it may be preferable to lower the corporate tax burden by following the global trend of reducing corporate tax rates rather than reintroducing these incentives on a broad scale.

OPTION TWO: Addressing The Statutory Rate

Australia's statutory rate is currently a little above the OECD average.

While there are a range of specific issues within the treatment of business taxation that can impact on Australia's competitiveness, reducing the statutory rate rather than aiming to narrow the existing broad company tax base may be the best policy option for Australia. According to a paper released by two Treasury officials:

> 'If reducing company tax to attract more foreign investment was thought justified, lowering the statutory company tax rate would generally be preferable to narrowing the company tax base because:
>
> - a broader base minimises distortions in the allocation of capital within Australia;
> - a lower statutory rate provides a better outcome in respect of profit shifting;
> - if competition between countries is primarily for discrete high-profit investments, then reducing the statutory rate is a better targeted response; and
> - a statutory company tax rate reduction is more visible and may provide a positive 'headline' effect for any given effective tax rate.'[17]

The statutory rate can act as a flag to companies and investors considering options for their mobile capital that a conducive environment for business exists in this country.

As previously noted, a reduction in the corporate tax rate does not necessarily result in lower corporate tax revenues. Both Ireland and Singapore have undertaken corporate tax reductions in recent years but as shown in the relevant charts, both countries continue to secure reasonably high corporate tax revenue. Singapore indicated in its 2005 Budget that corporate tax revenue was higher than expected despite a reduction in the corporate tax rate from 22 per cent to 20 per cent announced in its 2004 Budget.

17 Kelly, J. and Graziani, R. 'International Trends in Company Tax Rates – Implications for Australia's Company Income Tax'.

5.1 | CONCLUSION

The BCA called for a number of important reforms within both personal and company taxation in its report released in April 2005 *Taxation Action Plan for Future Prosperity.* Ideally the Government will undertake moves in the near future to ensure that the whole of Australia's taxation system maximises Australia's competitiveness by removing a number of fundamental barriers.

The reduction in the top two personal taxation rates will be an important element of this reform. In addition, on the basis that the Australian company tax base should remain this broad rather than be narrowed, Australia should reduce its statutory corporate tax rate to a level below those of our competitors, such as our Asian neighbours and countries in the EU, in order to bring the overall corporate tax burden in Australia to competitive levels.

However, if there were delays in the reduction of the top personal taxation rates, then exacerbating the difference between the top marginal rate and the company taxation rate may not be preferable. Reductions in the corporate tax burden may need to be undertaken through review and reform of specific areas in the treatment of business income in Australia.

A decrease in the corporate tax burden will reduce barriers to attracting mobile capital investment (particularly from offshore), increase Australia's competitiveness and assist Australia's productivity and longer-term prosperity. The need for such reform in Australia has never been greater given the competitive challenge Australia is already facing.

The BCA recommends that Government 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.

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.

Recommendations from this review should be provided in advance for inclusion in the 2006–2007 Federal Budget.

Appendix

NORWAY AND LUXEMBOURG'S HIGH CORPORATE TAX BURDEN

LUXEMBOURG

Luxembourg has the 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.'[18]

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 has the second-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.

Ordinary taxes from companies engaged in the extraction of petroleum, plus the special income tax on extraction of petroleum, comprise almost 44 per cent of the total taxation of wealth and income and about two-thirds of total corporate income tax.[19] Taxes on petroleum extraction are included in the calculation of the total corporate tax burden.

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.

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

19 Derived from data on Table 592 Statistical Yearbook (2004) Statistics Norway & OECD Revenue Statistics 1965–2003, OECD 2004 'Central Government, fiscal account including National Insurance Scheme Tax revenue'.

Glossary

ATO: Australian Taxation Office.

Corporate tax burden: the burden of taxation borne by corporations. Indices of the level of the corporate tax burden include the percentage of total taxation revenue or the percentage of GDP.

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.

Effective rate of corporate tax: the rate of taxation as a proportion of corporate profits inclusive of any offsets, deductions or concessions.

EU: European Union.

OECD: Organisation for Economic Co-operation and Development.

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